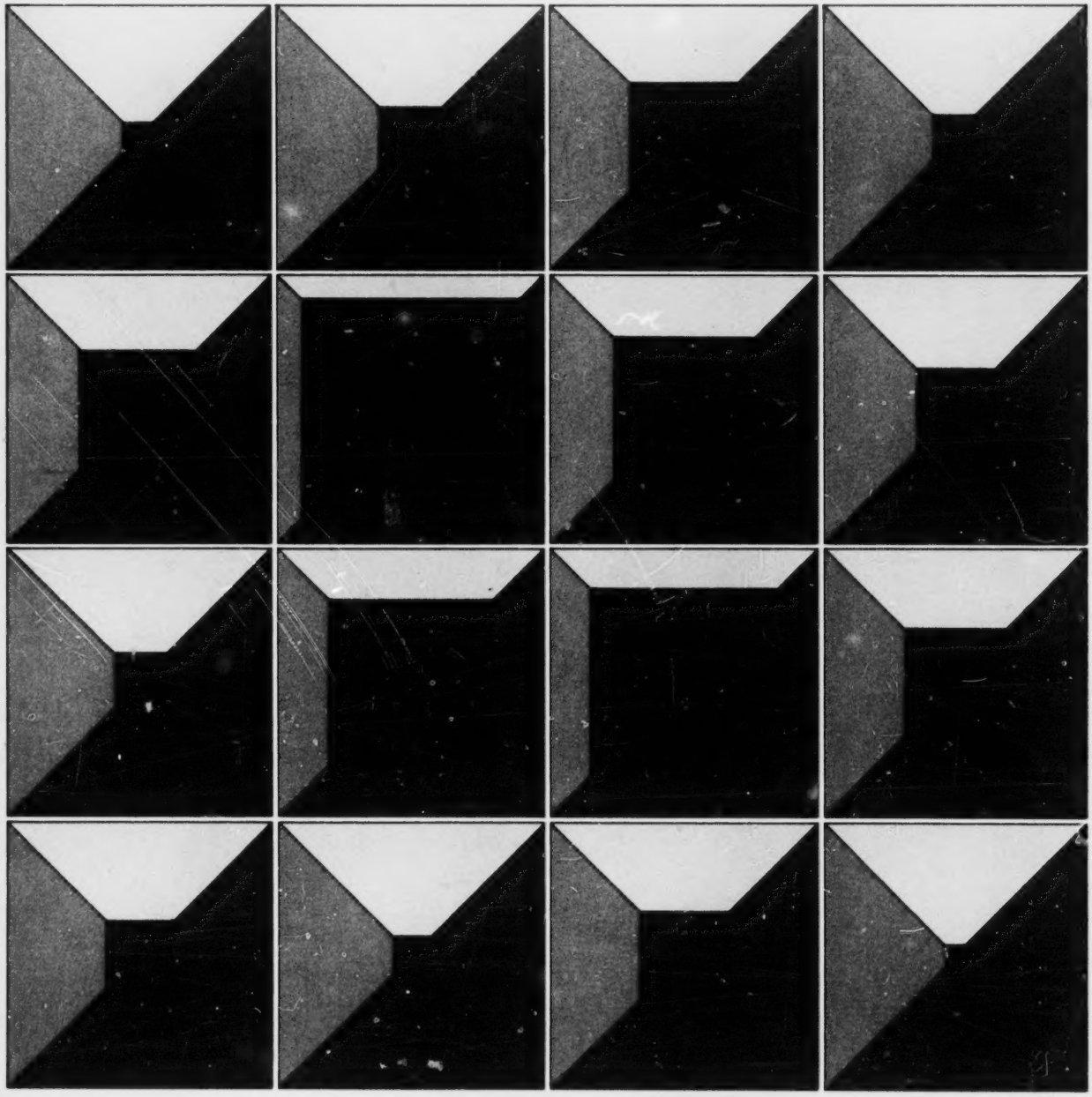
A CBO STUDY

Federal Housing Assistance: Alternative Approaches

May 1982

Congress of the United States
Congressional Budget Office



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FEDERAL HOUSING ASSISTANCE: ALTERNATIVE APPROACHES

The Congress of the United States
Congressional Budget Office

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PREFACE

After amending current housing assistance programs during each of the past few years in ways expected to reduce their cost, this year the Congress is considering proposals that would comprehensively restructure federal housing aid. This paper, requested by the Senate Budget Committee, describes current housing assistance programs and analyzes several comprehensive housing policy options.

Martin D. Levine of CBO's Human Resources and Community Development Division prepared this paper under the general direction of Nancy M. Gordon. Ben Steffen provided the computer analyses necessary for the study. Richard Bartholomew, John L. Goodman, Jr., Ann C. Hadley, Ira S. Lowry, Larry J. Ozanne, Philip A. Sampson, Cynthia M. Simon, and Raymond J. Struyk reviewed earlier drafts of the report and provided helpful comments. Many members of the CBO staff, including Roberta Drews, Cynthia Gensheimer, Wilhelmina Leigh, Patricia Ruggles, and Brent Shipp also contributed useful comments and necessary information. Numerous persons at the U.S. Department of Housing and Urban Development and the Farmers Home Administration of the Department of Agriculture provided program and budget data used in the study. Frank Pierce edited the paper. Mary Braxton expertly and patiently typed the several drafts and, with Nancy Brooks, prepared the manuscript for publication.

In accordance with CBO's mandate to provide objective and impartial analysis, this paper contains no recommendations.

Alice M. Rivlin
Director

May 1982

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SUMMARY

For more than 40 years, the federal government has subsidized the shelter costs of low- and moderate-income persons through a series of frequently changing rental and homeownership assistance programs. In fiscal year 1982, nearly $10 billion will be spent under such programs to aid more than 4.5 million households--representing more than 10 times the level of spending at the beginning of the last decade and almost four times the number of persons served. This rapid expenditure growth has prompted an increasing interest in alternative housing assistance approaches. Several such alternatives are being considered by the present Congress, and they seem likely to arise during the next few years as well.

PROGRAM OBJECTIVES

Federal housing assistance programs are intended principally to improve the housing conditions and to reduce the shelter costs of the poor. Over the past several decades, however, the housing circumstances of Americans have changed significantly. Rising personal incomes and the decision of many persons to consume more and better housing have reduced the incidence of substandard housing while increasing the average proportion of income devoted to shelter. One result of these trends is that the most common housing-related problem facing lower-income families today is not substandard housing but high housing-cost burdens. As of 1977, one-fifth of all renters with family incomes below 50 percent of the local median--the effective target group of most present federal programs--were living in dwellings requiring rehabilitation, while nearly two-thirds of all such households were spending more than 30 percent of their incomes for housing (see Summary Table 1).

In addition to dealing with the housing adequacy and cost problems of the poor, housing assistance programs are also expected to contribute to other policy objectives, including: promoting residential construction and dampening cyclical swings in building activity; increasing homeownership among low- and moderate-income persons; expanding the range of housing choices available to lower-income and minority-headed households; and promoting community preservation and revitalization. The net impact

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SUMMARY TABLE 1. PERCENT OF HOUSEHOLDS LIVING IN HOUSING UNITS REQUIRING REHABILITATION OR PAYING MORE THAN 30 PERCENT OF INCOME FOR HOUSING, BY TENURE AND INCOME: 1977

Housing Conditions and Expenditures[a]	Annual Family Income[b]				
	Very Low	Low	Moderate	Middle and Upper	All Households
Renters					
Living in units requiring rehabilitation	19.8	12.4	10.7	8.2	14.0
Housing expenses exceeding 30 percent of income	62.7	26.2	7.0	1.7	30.4
Homeowners					
Living in units requiring rehabilitation	9.3	4.3	2.5	2.0	3.7
Housing expenses exceeding 30 percent of income	47.2	20.1	11.4	3.1	13.2

SOURCE: CBO estimates based on 1977 Annual Housing Survey.

a. See text of paper for definition of units requiring rehabilitation and description of housing expenses considered.

b. Income classification based on that used in federal housing assistance programs. For four-person households, the definitions are:

Very low	=	Annual family income less than or equal to 50 percent of area median.
Low	=	Annual family income between 51 and 80 percent of area median.
Moderate	=	Annual family income between 81 and 95 percent of area median.
Middle and upper	=	Annual family income greater than 95 percent of area median.

of housing assistance programs on these other objectives is difficult to assess, however, and has generally been secondary to the effects of other federal policies, including tax and monetary policies, mortgage insurance programs, and direct community development programs.

CURRENT HOUSING ASSISTANCE PROGRAMS

Present housing assistance programs serve both renters and homebuyers over a wide income range, but most of the benefits go to renters with incomes below 50 percent of the local median. Under most programs, the government makes multiyear commitments to pay subsidies equal to the difference between a fixed proportion of income that households are expected to contribute to their own housing expenses (generally 25 percent today but due to rise to 30 percent by 1986) and the full market cost of the dwellings they occupy.

The cost to the government of current programs varies appreciably, depending primarily on whether assisted families are housed in newly built structures or in less-costly existing housing units. The average first-year direct subsidy cost of commitments made in 1982 is expected to range from about $2,200 per household under the existing-housing assistance program to more than $6,000 per household under some new construction programs.

In contrast to other federal income supplements, which are available to all qualifying households, housing assistance is limited by annual budget decisions. Under most housing programs, aid is extended each year to some number of additional households, expanding program coverage and contributing to federal outlays for many years into the future. Through fiscal year 1982, approximately 4 million rental assistance commitments and 1.3 million homeownership assistance commitments will have been made, obligating the government to long-term expenditures of more than $240 billion. Together, these commitments will be sufficient to serve approximately 28 percent of all renters in the effective target group and about 6 percent of all homeowners with incomes low enough to qualify for homeownership assistance.

ALTERNATIVE POLICY APPROACHES

Concern with the increasing costs of current housing programs and their limited coverage has led to a number of proposals that

would comprehensively restructure federal housing aid. One obvious course would be to cease making additional housing assistance commitments, leaving the current inventory of assisted units to serve lower-income households and using any additional resources to supplement general income assistance programs. Such an approach would address the income problem of the poor and would grant assisted households maximum flexibility in using their assistance, but would do little to deal with the remaining housing adequacy problems.

Alternative approaches that would continue to expand housing aid include:

- o Housing vouchers;
- o Housing assistance block grants; and
- o A multiple-program approach involving separate lower-income assistance and production-subsidy programs (see Summary Table 2).

Elements of these alternatives are included in the Administration's 1982 legislative proposals and in housing and community development acts reported out of the Senate and House Banking Committees this year.

Housing Vouchers

One alternative to current programs would be to offer housing assistance primarily through cash or cash-equivalent vouchers provided directly to lower-income persons living in housing of their own choosing that meets prescribed physical adequacy standards. Under a voucher system--which would closely resemble the present Section 8 existing-housing program--households would receive payments equal to the difference between some percent of their incomes and benchmark amounts corresponding to the estimated cost of modest-priced, physically adequate housing. Persons selecting units costing more than the appropriate benchmark amount would pay the full additional expense themselves; those choosing to live in less-costly dwellings would realize all of the savings. Because vouchers would probably not be immediately available to all qualifying households, local administering agencies would have to ration aid, as they do under current programs.

Likely Impacts. Housing vouchers, which could be used to aid homeowners as well as renters, would concentrate resources on

SUMMARY TABLE 2. COMPARISON OF CURRENT HOUSING ASSISTANCE PROGRAMS AND ALTERNATIVE APPROACHES

Policy Alternative	Objectives Served	Types of Households Assisted	Average Annual Cost per Household Assisted[a]
Current Housing Assistance Programs	Principally aiding lower-income households and supporting new residential construction.	Principally very-low-income renters.	$3,650
Housing Vouchers	Principally aiding lower-income households.	Exclusively very-low-income households.	$2,150
Housing Assistance Block Grants	Depend on federal guidelines and local program-design decisions.		
Multiple-Program Approach			
Lower-income housing vouchers; separate block grants or production subsidies to support rehabilitation or construction	Similar to current programs but different policy tools used to address different objectives.	Very-low-income households through vouchers. Principally somewhat higher-income households through separate production subsidy.	$2,150 per voucher recipient. Costs under block grants depend on local decisions. Production subsidy costs depend on program design and income group served.

a. Figures represent estimated direct expenditures in constant dollars for the first year of assistance per additional assistance commitment made in 1983. Estimated average cost under current programs assumes 55 percent existing-housing assistance and 45 percent new construction mix--the program mix expected to result from the fiscal year 1982 authorizing legislation at the time it was enacted. See accompanying text for description of specific voucher option.

alleviating housing-cost burdens among the poor. Findings from a government-sponsored voucher experiment together with experience under the Section 8 existing-housing program indicate that vouchers would also be likely to induce some upgrading of marginally substandard units but would probably not generate repairs to many seriously dilapidated structures or promote additional residential construction. There is no evidence that housing vouchers would cause inflation in rents.

Program Costs. Housing vouchers would be appreciably less costly than the current mix of housing aid. Assuming that subsidies were capped at levels 5 percent below the present Section 8 existing-housing subsidy benchmarks, the average annual cost per household aided in 1983 through vouchers would be about $2,150, or 40 percent less than the average expense under the current program mix and 8 percent less than the average cost under the Section 8 existing-housing program. Lower subsidy caps would reduce program costs still further but would also risk making large segments of local markets financially inaccessible to assisted households.

Housing Assistance Block Grants

A second policy alternative would be to fold current housing assistance programs into one or more block grants to be spent by state and local governments under programs of their own design. In its most inclusive form, all current direct housing assistance programs would be folded into a single, loosely-restricted grant. A more limited block grant might supplant only certain kinds of programs--for example, those providing lower-income rental assistance--while restricting the use of funds to corresponding types of assistance.

Likely Impacts. The policy goals emphasized under a block grant would depend both on federal guidelines and on the program-design decisions made locally. The degree to which funds would benefit low-income persons, for example, would depend on the income-targeting requirements established. Similarly, the relative emphasis on the housing adequacy and affordability problems of the poor would depend on the distribution of assistance among new-construction, rehabilitation, and existing-housing programs.

Program Costs. The average expenditure per household aided under a block grant program would depend on the types of assistance provided locally. Whatever form aid was provided in, however, some administrative savings would likely be realized at the

federal level. State and local administrative expenses, on the other hand, could increase—at least in the short run—as those governments took over additional program-design and management responsibilities.

A Multiple-Program Approach

A third option--encompassing elements of the other two--would be to use separate programs to pursue separate policy objectives. Under this approach, vouchers could be relied upon to aid lower-income households. Some combination of limited-use block grants and separate federally administered production subsidies could then be used to fund housing rehabilitation and to promote the construction of additional rental units that would be available to persons over a wider income range than would benefit from vouchers.

Likely Impacts. This approach would use a combination of devices to serve some of the same goals addressed by current programs. By differentiating between lower-income assistance and construction/rehabilitation support, however, the system as a whole would probably be more efficient, making it possible to aid more lower-income persons while subsidizing the upgrading or construction of more housing units at less expense. On the other hand, any multiple-program approach that included production subsidies targeted less toward low-income households would necessarily divert some funds from those most in need.

Program Costs. The cost of the voucher component of such a scheme would be as described above. Average per-household expenditures under a supplementary block grant would depend on rules governing eligible uses and on the actions of state and local governments. Costs under a separate production subsidy would depend on how large a subsidy was provided and on the subsidy mechanism used. Using a mortgage assistance grant to reduce mortgage interest rates on newly built rental housing by between three and seven percentage points, for example, would require one-time expenditures of between $9,400 and $21,500 per unit. Averaged over a 20-year subsidy term, the cost would amount to between $500 and $1,100 per unit.

POLICY TRADEOFFS

The choice among current housing programs and these alternatives presents an important set of policy tradeoffs:

- Current federal efforts provide housing assistance primarily to very-low-income renters through programs also expected to contribute to residential construction. Pursuing both objectives through lower-income new construction programs results in high program costs but assures that some number of newly built--and, presumably, higher-quality--housing units are available to the poor.

- Housing vouchers would concentrate resources on the affordability problems of the poor and would make it possible to assist the largest number of households at the lowest possible cost. While vouchers would result in upgrading of some existing marginally substandard dwellings, they would do little to expand the total supply of housing.

- Housing block grants would delegate to states and localities the responsibility for designing and targeting aid. Without fairly strict income-targeting requirements--as govern current housing programs--block grants could, therefore, divert assistance from those most in need. The average cost per household assisted under a block grant is difficult to forecast.

- A multiple-program approach would focus lower-income assistance on problems of housing affordability, while dealing separately with remaining housing adequacy and supply problems. By divorcing these policy objectives from each other, the Congress could continue to pursue all of them at less total cost than under current programs. Such a system would, however, necessarily divert some funds from the lowest-income households in order to help finance additional housing for better-off persons.

FEDERAL HOUSING ASSISTANCE:
ALTERNATIVE APPROACHES

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CHAPTER I. INTRODUCTION

The federal government will spend nearly $10 billion in fiscal year 1982 under a variety of housing assistance programs to subsidize the living costs of more than 4.5 million low- and moderate-income households.[1] This represents more than a tenfold increase in expenditures and nearly a fourfold rise in the number of households served since 1970 alone, making housing assistance one of the most rapidly growing components of the federal budget. Furthermore, commitments already outstanding will increase outlays sharply in the next few years and keep them at high levels for many years to come, regardless of how many additional commitments are made in the future. Past expenditure increases and the prospect of continuing steep rises have led to a number of curbs on program growth and, more recently, to proposals that would restructure comprehensively federal housing aid.

RECENT EXPERIENCE

Since the 1930s, the federal government has subsidized the housing costs of a growing number of low- and moderate-income persons through rental and homeownership programs that involve assistance commitments of up to 40 years. In contrast to other kinds of income supplements, which are available to all households that qualify, housing assistance is limited by annual budget decisions to only a small proportion of the eligible population. Under most housing programs, aid is extended each year to some number of additional households--expanding program coverage, adding to the volume of outstanding obligations, and contributing to outlays for many years to come.

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1. Expenditure figure includes outlays under the Section 8, public housing, rent supplement, and Section 236 rental assistance programs and the Section 235 homeownership assistance program plus interest-subsidy costs under outstanding Farmers Home Administration loans and expenditures under the rural rental assistance program. (Program names refer to sections of various federal housing acts.)

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After a long period of relatively slow program growth, the number of new assistance commitments made each year--and, thus, both outlays and outstanding obligations--increased sharply during the last decade. During the 30 years ending in 1970, an average of about 50,000 additional assistance commitments were made annually. Since then, however, the number of new subsidy commitments has averaged more than 400,000--except for a two-year partial moratorium on new commitments in the mid-1970s--and expenditures have grown by more than 25 percent each year. Because of the one- to four-year lag between the commitment date and the time when a new household begins to receive aid, outstanding subsidy agreements will increase outlays by more than $3 billion by 1987, even if no new commitments are made after this year.[2] The long-term obligation associated with commitments expected to be outstanding at the end of fiscal year 1982 will exceed $240 billion.[3]

Concern with rising expenditures and mounting obligations has prompted a number of actions during the last several years intended to slow spending increases without affecting the basic design of present programs. These actions have included: reducing the number of additional housing assistance commitments made each year; subsidizing proportionately more renters living in existing rather than in newly built housing; increasing the share of their incomes that assisted tenants are required to contribute toward their own housing expenses; and requiring that persons receiving homeownership assistance repay some portion of the subsidy received if they eventually sell their homes at a profit.

CHOICES FOR 1982 AND BEYOND

More recently, attention has shifted from amending current programs to identifying alternative approaches. Alternative housing assistance approaches that have been suggested during the past few years include:

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2. Estimate, based on funding provided in appropriations acts passed during the first session of the 97th Congress.

3. Figure represents total obligations expected to be outstanding at the end of fiscal year 1982 under Department of Housing and Urban Development programs. Outstanding Farmers Home Administration assistance commitments obligate the government to several billion dollars more in future expenditures. (Current programs and program costs are described more fully in Chapter III.)

- Aiding lower-income families principally through housing vouchers that they could use to pay part of their living costs in privately owned dwellings of their own choosing;

- Providing housing assistance block grants to state and local governments to fund programs of their own design; and

- Dividing the currently intermingled goals of assisting lower-income persons and promoting housing construction and rehabilitation by offering separate lower-income assistance and production-subsidy programs.

Elements of each of these approaches were included in the Administration's legislative proposals for fiscal year 1983 and are incorporated in housing and community development acts ordered reported out of the Senate and House Banking Committees this year.

This paper is intended to assist the Congress in considering these policy alternatives during the remainder of this session of Congress and in the years ahead. Chapter II describes housing assistance program objectives and assesses present housing conditions. Chapter III examines current federal housing assistance efforts. Chapter IV compares the costs and impacts of the three alternatives mentioned above. The final chapter examines program-design issues and options associated with each approach. An appendix describes specific provisions of the housing bills reported out of the two Banking Committees.

CHAPTER II. PROGRAM OBJECTIVES AND CURRENT HOUSING CONDITIONS

Federal housing assistance programs are intended primarily to improve the living conditions and reduce the housing expenses of low- and moderate-income persons. In addition, however, most such programs are also expected to serve one or more other goals, including: promoting residential construction, increasing homeownership, expanding housing opportunities for disadvantaged groups, and encouraging community preservation and revitalization. This chapter describes housing assistance program objectives and examines recent trends in housing conditions.

IMPROVING HOUSING CONDITIONS AND REDUCING HOUSING COSTS

All housing assistance programs are designed to reduce the number of lower-income persons living in substandard housing and also to lower their housing costs. In the more than 40 years that the federal government has provided such aid, however, the nature of housing-related problems has changed substantially. During that period, the incidence of substandard housing has declined sharply, while the share of household income devoted to shelter has increased. As a result, high housing-cost burdens--that is, large proportions of income paid for shelter--are by far the most common housing-related problem facing lower-income persons today.

Improving Housing Conditions

By any available measure, housing quality has improved greatly in recent decades. Between 1940 and 1970, the proportion of all occupied housing units that were either physically dilapidated--a Census indicator of severe substandardness--or lacked complete plumbing facilities declined from 49 percent to just over 7 percent (see Table 1). Applying a different measure, as of 1977, approximately 5.5 million occupied housing units--or 7.4 percent of the total--were judged to be in need of some rehabilitation.[1] The most seriously deficient units represent a

1. The measure of housing condition employed here differs slightly from an earlier version used in a previous Congres- (Continued)

still smaller proportion--and more rapidly declining share--of all occupied dwellings.

Those housing deficiencies that remain are heavily concentrated among lower-income persons, especially renters. As of 1977, 17 percent of all renters with incomes low enough to quality for federal lower-income housing assistance--those with family incomes no greater than 80 percent of the area median--were living in units requiring rehabilitation. Among very-low-income renters--defined legislatively as those with family incomes no greater than 50 percent of the area median--the rate was nearly 20 percent (see Table 2). As of the same year, 7 percent of all lower-income homeowners and 9 percent of all very-low-income homeowners were living in units judged to be in need of rehabilitation.

Most of the general improvement that has taken place in housing conditions has been the result of high rates of private residential construction--permitting the replacement of deficient dwellings--and the upgrading of existing, physically inadequate structures. Both of these trends have, in turn, been largely due to rising personal incomes and the decisions of many persons to spend much of their added income for improved shelter. The construction of federally assisted projects set aside for lower-income families has played a relatively minor role in overall quality gains, accounting for less than one-tenth of the 12 million reduction between 1940 and 1970 in the number of households living in substandard housing. Federally assisted construction does, however, account for a substantial share of all well-housed lower-income persons. As of 1977, one-fifth of all very-low-income renters living in physically adequate units were receiving federal aid.

Reducing Housing-Cost Burdens

Trends in housing expenditures have been more complex than the trends in quality. Considering renters first, over the last several decades rents for constant-quality housing units have risen more slowly than has the median family income, allowing most families to afford the same quantity of housing for a smaller proportion of their income. At the same time, although the purchase

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1. (Continued)
sional Budget Office report, Federal Housing Policy: Current Programs and Recurring Issues (June 1978).

TABLE 1. PERCENT OF ALL HOUSING UNITS WITH SELECTED CONDITIONS: 1940-1977

Condition	1940	1950	1960	1970	1977
Lacking Some or All Plumbing Facilities	44.6	34.0	15.2	5.1	2.4
Dilapidated[a]	18.1	9.1	5.8	3.7	NA
Lacking Some or All Plumbing Facilities and/or Dilapidated	48.6	35.4	17.0	7.4	NA
In Need of Rehabilitation[b]	NA	NA	NA	NA	7.4

SOURCES: Unpublished Census data and CBO analysis of 1977 Annual Housing Survey

NA = Not available.

a. The Census definition of dilapidation has varied over time.

b. A unit is classified as in need of rehabilitation if it has at least one major deficiency or if it has two or more secondary defects. The major deficiencies are: (1) the absence of complete plumbing facilities; and (2) the absence of complete kitchen facilities. The secondary defects are: (1) three or more breakdowns of six or more hours each time in the heating system during the previous winter; (2) three or more times completely without water for six or more hours each time during the preceding 90 days, with the problem inside the unit; (3) three or more times completely without flush toilet for six or more hours each time during the preceding 90 days, with the problem inside the unit; (4) leaking roof; (5) holes in interior floors; (6) open cracks or holes in interior walls or ceilings; (7) broken plaster or peeling paint over more than one square foot of interior walls or ceilings; (8) unconcealed wiring; (9) the absence of any working light in public hallways for multi-unit structures; (10) loose or no handrails in public hallways for multi-unit structures; and (11) loose, broken, or missing steps in public hallways in multi-unit structures.

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TABLE 2. NUMBER AND PERCENT OF HOUSEHOLDS LIVING IN UNITS REQUIRING REHABILITATION, BY TENURE AND INCOME: 1977 (In thousands of households)

	Annual Family Income[a]				
	Very Low	Low	Moderate	Middle and Upper	All Households
Renters					
Living in units requiring rehabilitation[b]	2,112	731	240	639	3,722
As percent of all households in category	19.8	12.4	10.7	8.2	14.0
Homeowners					
Living in units requiring rehabilitation[b]	829	345	111	540	1,825
As percent of all households in category	9.3	4.3	2.5	2.0	3.7

SOURCE: CBO estimates based on 1977 Annual Housing Survey.

a. Income classification based on that used in federal housing assistance programs. For four-person households, the definitions are:

Very low	=	Annual family income less than or equal to 50 percent of area median.
Low	=	Annual family income between 51 and 80 percent of area median.
Moderate	=	Annual family income between 81 and 95 percent of area median.
Middle and upper	=	Annual family income greater than 95 percent of area median.

Threshold amounts for households of less or more than four persons are somewhat lower and higher than these amounts.

b. See Table 1 for definition of housing in need of rehabilitation.

price of homes rose sharply during the past decade, the expectation of capital gains after purchase and the large shares of homeownership expenses that are deductible from income in determining federal tax liability caused the net effective after-tax cost of buying and maintaining a home to decline in real terms during most of the 1970s. This, in turn, has induced many homebuyers to devote larger shares of their incomes to housing and has led other persons who might otherwise have rented to purchase homes instead--leaving rental housing increasingly the domain of the less well off.[2]

As a result of all these trends taken together, the proportion of all households paying large shares of their incomes for housing has grown. Among renters alone, the proportion paying more than one-fourth of their incomes for housing rose from 32 percent in 1950 to 51 percent by 1979--reflecting both the movement of higher-income families to owner-occupancy and the preferences of those who remained as renters. Among homeowners, the proportion spending more than one-fourth of their incomes for shelter rose from 16 percent to 21 percent between 1974 and 1978 alone. The proportion of all first-time homebuyers devoting more than one-fourth of their incomes to housing grew from 29 percent to 40 percent during the same period and has almost certainly increased since then as well.[3]

Although increasing housing-cost burdens reflect free choices for many persons, rising shelter costs have left large numbers of lower-income persons facing potentially burdensome housing expenses, with the problem especially pronounced among renters. As of 1977, nearly two-thirds of all very-low-income renters and almost one-half of all very-low-income homeowners were paying more than 30 percent of their incomes for housing (see Table 3). As of the same year, 29 percent of all very-low-income renters and 17 percent of all very-low-income homeowners were spending more than one-half of their incomes for shelter.

Most federal housing assistance programs address the housing-cost burdens of the poor by limiting participants' out-of-pocket housing expenses to a fixed proportion of their incomes--25 percent today for most programs but due to rise to 30 percent by

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2. For a more complete discussion of trends in housing costs and expenditures, see The President's Commission on Housing: Interim Report (October 30, 1981), pp. 18-30.

3. CBO tabulations of Annual Housing Surveys.

TABLE 3. PERCENT OF HOUSEHOLDS SPENDING SPECIFIED SHARES OF INCOME FOR HOUSING, BY TENURE AND INCOME: 1977

Tenure and Percent of Income Paid for Housing[a]	Annual Family Income[b]				All Households
	Very Low	Low	Moderate	Middle and Upper	
Renters[c]					
0 - 30 percent	37.4	73.8	93.0	98.3	69.6
31 - 50 percent	34.2	23.8	6.5	1.6	19.3
51 percent or more	28.5	2.4	0.5	0.1	11.1
Median Percent of Income Paid for Housing[d]	40	25	20	15	23
Homeowners[e]					
0 - 30 percent	52.8	80.0	88.5	96.9	86.8
31 - 50 percent	29.8	17.5	10.5	2.9	10.0
51 percent or more	17.4	2.6	0.9	0.2	3.2
Median Percent of Income Paid for Housing	29	20	18	13	16

SOURCE: CBO estimates based on Annual Housing Survey.

a. Housing costs for renters include rent payments due the landlord plus utility and fuel costs not included in the rental payment. Housing costs for homeowners include principal and interest payments on the mortgage, real estate taxes, property insurance, utilities, fuel, water, and garbage and trash collection fees.

b. See Table 2 for definitions of income categories.

c. Excludes renters of single-family homes on ten acres or more.

d. Excludes households paying no cash rents.

e. Limited to owner-occupants of single-family homes on less than ten acres and with no business on the property.

fiscal year 1986. Although only a small minority of all eligible families receive aid, those families constitute a large share of all poor households with low housing-cost burdens. As of 1977, while only about one-fifth of all very-low-income renters were receiving federal assistance, those households represented half of all very-low-income tenants spending no more than one-fourth of their incomes for shelter.

OTHER POLICY OBJECTIVES

In addition to improving the living conditions and reducing the housing costs of lower-income persons, most federal housing assistance programs are also expected to address other policy objectives, including:

- Promoting housing production and dampening cyclical swings in residential construction;
- Increasing homeownership;
- Expanding housing opportunities for disadvantaged groups and for persons with special housing needs; and
- Promoting neighborhood preservation and revitalization.

In pursuing these goals, lower-income housing assistance programs generally play a secondary role to other federal measures, including: tax and regulatory policies, federal mortgage insurance programs, and direct community development aid.

Promoting Residential Construction and Stabilizing the Construction Industry

Assuring a supply of new housing sufficient to meet demand, and dampening swings in residential construction, have long been federal policy objectives. Recently, concern regarding the adequacy of supply has focused principally on rental housing; cyclical volatility is generally viewed as a greater problem in the much larger single-family, owner-occupancy submarket.

Federal housing assistance programs contribute to overall residential construction through the production of rental housing projects set aside for lower-income families and by subsidizing the purchase of newly built homes for limited numbers of low- and

moderate-income persons. In neither instance, however, does the net impact of federal aid equal the full volume of assisted construction, because much of the federally aided construction almost certainly substitutes for privately financed activity that would have occurred in any event.[4]

The net impact of federally assisted construction on cyclicality in the construction industry has been uneven. Although federally assisted activity has occasionally accounted for large proportions of all construction--particularly in the multifamily submarket--aided construction has by no means acted as a consistently countercyclical force. Indeed, during the early- to mid-1970s, assisted construction occurred largely procyclically--contributing to, rather than alleviating, market swings.[5] Overall, general monetary policy and tax provisions affecting

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4. Estimates of the degree of substitution between federally subsidized multifamily construction and activity that would have occurred in any event run as high as 60 percent. See James E. Wallace, "The Section 8 New Construction Program," staff background paper prepared for Committee on Federal Housing Programs and Alternatives, The President's Commission on Housing (August 26, 1981).

5. Beginning in the late 1970s, as construction starts for privately financed multifamily housing dropped off sharply, federally aided building has come to account for an increasingly large share of all activity in that submarket--representing two-thirds of all multifamily construction starts in 1980. This likely reflects some combination of (a) an increasing substitution of federally assisted activity for privately financed construction that would have occurred in any event, and (b) the declining profitability of rental housing as an investment that may have discouraged privately sponsored construction even in the absence of large amounts of federal aid. For varying views regarding the adequacy of recent rates of privately financed rental housing production and future prospects, see, among others: General Accounting Office, Rental Housing: A National Problem That Needs Immediate Attention (November 1979); U.S. Department of Housing and Urban Development, Rental Housing: Condition and Outlook, a 1981 report to the Congress; George Sternlieb and Robert W. Burchell, "Multifamily Housing Demand: 1980-2000," Journal of American Real Estate and Urban Economics Association (Spring 1979); and John C. Weicher and others, Rental Housing: Is There a Crisis? (The Urban Institute, 1981).

housing have almost certainly had much greater impacts on total housing production and on the timing and severity of housing cycles.

Increasing Homeownership

For many years, the federal government has promoted homeownership through favorable tax treatments for homeownership expenses, the regulation of private lending institutions to funnel credit into residential mortgages, and large-scale mortgage insurance programs. In part as a consequence of these policies, the proportion of all households owning their own homes has increased steadily over the past several decades, growing from less than one-half in 1940 to nearly two-thirds in 1980. Furthermore, homeownership rates continued to increase slightly even in the face of the especially sharp price increases that occurred during the last decade. Indeed, in one respect, those price rises may have helped fuel the continued movement toward homeownership by making the decision to buy a home increasingly an investment as well as a shelter choice. The sharp and persistent rise in mortgage interest rates that has taken place during the last few years may, however, dampen this movement, at least in the near future.

Direct housing assistance programs have helped substantial numbers of low- and moderate-income persons purchase homes but--because of their limited scope--have contributed little to overall homeownership gains. During the early 1970s, when these programs were most active, up to 260,000 homebuyers were aided in any one year. This figure is small compared to the 1.6 million to 2.1 million renters who bought homes annually during the mid-1970s but is substantial relative to the 500,000 to 700,000 low- and moderate-income renters who purchased homes each year between 1974 and 1978.

Expanding Housing Opportunities

Another goal of housing assistance programs has been to enhance locational opportunities for disadvantaged groups and to expand the supply of dwellings available to those with special housing needs. In this vein, housing programs have been used to increase the access of lower-income persons to high-cost areas, to expand opportunities for minority-headed households in areas with low concentrations of minorities, and to increase the supply of housing units designed to meet the needs of the elderly and the

handicapped. Expanding the locational choices of lower-income and minority-headed households has generally involved locating federally assisted housing projects in neighborhoods that may previously have been closed to them. More recently, rent subsidies for persons living in existing dwellings have also been used to expand housing access. Increasing the supply of housing for the elderly and the handicapped has generally involved setting aside certain numbers of units--or, in the case of the elderly, entire projects--for them.

Promoting Community Preservation and Revitalization

For some years now, housing programs have also been expected to help promote community preservation and revitalization. Most often this has involved attempts to use federally assisted housing projects to spur further residential and commercial investment in declining areas or to arrest decline in areas beginning to experience disinvestment. More recently, there has been interest in using housing assistance to maintain economic integration in areas undergoing rapid reinvestment with its associated increases in housing costs. The net effect of federal housing aid in achieving either of these objectives is difficult to assess.

CHAPTER III. PRESENT FEDERAL EFFORTS

Numerous federal housing assistance programs address the policy objectives discussed above. This chapter describes current assistance programs, their budget treatment, and the volume of housing subsidy commitments outstanding.[1]

CURRENT PROGRAMS

Federal housing assistance programs subsidize the shelter costs of both renters and homeowners over a wide income range. Most federal assistance, however, is directed to very-low-income renters living either in predesignated newly built projects or in previously existing dwellings of their own choosing. Taken together, federal housing assistance programs serve a small proportion of all eligible households at a high average cost per beneficiary.

The principal currently active housing assistance programs--listed in Table 4--include the following:[2]

- o Section 8 rental assistance;
- o Public housing;

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1. This chapter describes only direct expenditures for housing. The numerous federal tax provisions that subsidize the consumption or production of housing are not considered. Together, those provisions, which benefit principally middle- and upper-income homeowners and investors in rental housing, are expected to result in revenue losses of more than $30 billion in fiscal year 1982--more than three times the expected level of direct expenditures for lower-income housing aid.

2. Table 4 also describes outstanding assistance commitments and present expenditures under two currently inactive rental assistance programs--the Section 236 mortgage interest subsidy program and the rent supplement program. Commitments (Continued)

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- Section 235 homeownership assistance;
- Farmers Home Administration homeownership and rental assistance programs;
- Section 312 rehabilitation loans; and
- Housing assistance funded through the Community Development Block Grant (CDBG) and Urban Development Action Grant (UDAG) programs.

Section 8 Rental Assistance

The Section 8 rental assistance program, administered by the U.S. Department of Housing and Urban Development (HUD), is the largest and most rapidly growing housing assistance program. First authorized in 1974, the Section 8 program subsidizes lower-income persons living in newly built, rehabilitated, or existing physically standard dwellings. Under all the program variants, tenants contribute a fixed percentage of their incomes toward their own housing costs--currently set at 25 percent of adjusted income for most households but due to rise to 30 percent by fiscal year 1986.[3] The federal government pays the property owners the difference between the tenant contributions and the full market rents on the units.

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2. (Continued)
and expenditures are not listed separately for the Section 202 program, which provides direct loans to nonprofit sponsors to finance rental housing projects for the elderly and for handicapped persons. Most dwellings financed with Section 202 loans are also subsidized through one of the rent subsidy devices listed in Table 4. Since 1974, all Section 202-financed projects have also received aid under the Section 8 new construction/substantial rehabilitation program described in this chapter.

3. The Budget Reconciliation Act of 1981 raised the rent-to-income ratio from 25 percent to 30 percent of income, while granting the Department of Housing and Urban Development the flexibility to phase in the increase between fiscal years 1982 and 1986. The Department has announced its intent to apply the 30-percent-of-income standard immediately to all new tenants while phasing in the increase over the next five years for already-assisted households.

TABLE 4. CURRENT HOUSING ASSISTANCE PROGRAMS

Program	Assistance Commitments Outstanding through 1981 (thousands of households)	Additional Commitments Fundable in 1982[a] (thousands of households)	Total Direct Expenditure in 1982 (millions of dollars)[b]
Section 8 Rental Assistance			
New construction and substantial rehab.	794	46	2,016
Existing housing and moderate rehab.	970	133[c]	1,902
Public Housing	1,398	24	2,839
Section 236 Rental Assistance	537[d]	--	665
Rent Supplement Program	158	--	276
Section 235 Homeownership Assistance	265	15	285
Farmers Home Administration Rural Housing Programs			
Homeownership loans	961	68	1,186
Rental housing loans and rental assistance	254[e]	29	423
Section 312 Rehabilitation Loans	122[f]	5	NA
CDBG- and UDAG-Funded Housing Programs			
CDBG-funded programs	450[g]	225	NA
UDAG-funded programs	59	10	NA

(Continued)

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TABLE 4. (Continued)

SOURCES: U.S. Department of Housing and Urban Development and Department of Agriculture budget and program evaluation documents, and CBO estimates.

NOTE: All years are fiscal years. NA = Not available.

a. Estimates of additional subsidy commitments fundable in 1982 are based on funding levels provided in appropriations acts passed during the first session of the 97th Congress plus unspent budget authority carried over from fiscal year 1981. The expected mix among Section 8 and public housing commitments reflects the Department of Housing and Urban Development's current spending plan, assuming the use of all available funds.

b. Direct expenditures are estimated outlays in all cases except for Farmers Home Administration (FmHA) programs. Expenditures for FmHA programs include annual interest-subsidy costs for outstanding loans plus rental assistance payments for occupied units.

c. Includes 117,000 commitments involving the conversion of outstanding subsidy agreements from other assistance devices to Section 8 existing-housing.

d. Includes approximately 160,000 households receiving Section 8 existing-housing assistance or rent supplement aid in addition to the benefits of the mortgage-interest subsidies provided through the Section 236 program.

e. Total number of dwelling units in projects financed with rural rental housing loans since the outset of the program. Commitments were also outstanding to provide supplementary rental assistance payments on behalf of the occupants of 81,000 of those units.

f. Number of units covered by all Section 312 loans written through the end of fiscal year 1981. This figure is not adjusted to reflect loan repayments.

g. Estimated number of dwelling units rehabilitated with CDBG funds provided through fiscal year 1981.

New Construction and Substantial Rehabilitation. Under the Section 8 new construction and substantial rehabilitation programs, the federal government subsidizes persons living in new or largely rebuilt housing. In these programs, HUD enters into 20- to 40-year assistance agreements with property owners, helping to assure a long-term rental income stream for those units set aside for lower-income tenants. Most Section 8 projects also benefit from one of several financing subsidies that reduce the effective interest rates paid on project mortgages.

Approximately 790,000 Section 8 new construction and substantial rehabilitation assistance commitments were outstanding at the end of fiscal year 1981, and about 46,000 additional commitments are fundable in 1982.[4] Starting rents in newly assisted projects are likely to average about $7,000 per year, with federal assistance payments exceeding $5,000 per unit when those projects are first occupied.[5] Supplementary financing subsidies will contribute several hundred dollars more per unit in outlays or forgone tax revenues. Rental assistance payments alone associated with the 580,000 units expected to be eligible for payment in 1982 are expected to total about $2 billion.

Existing Housing and Moderate Rehabilitation. The Section 8 existing-housing and moderate rehabilitation programs aid persons living in existing physically standard units or in dwellings that can be brought up to standards with limited repairs. Under both these programs, HUD enters into 15-year contracts with local housing agencies to subsidize persons residing in units of their own choosing in the private market. In both cases, the dwellings must eventually pass minimum quality standards and must rent for no greater than HUD-established maximums. Because funds are available to serve only a small portion of all eligible households, administering agencies must ration aid locally by selecting beneficiaries from among qualifying applicants.

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4. All estimates of numbers of assistance commitments supportable in 1982 are based on funding levels provided in appropriations acts passed during the first session of the 97th Congress plus unspent budget authority carried over from 1981. The estimates do not reflect funding rescissions proposed by the Administration.

5. Per-unit cost estimates appearing in this chapter are based on the latest available program information, adjusted for future years in accordance with Congressional Budget Office economic assumptions as of January 1982.

Approximately 970,000 subsidy commitments had been made under these programs through September 1981. Another 133,000 commitments are fundable in fiscal year 1982, of which 117,000 will entail the substitution of Section 8 existing-housing assistance for some other form of aid for already-assisted dwellings. Annual full market rents for the net additional commitments are expected to average $3,600 for existing, near-standard units and $4,600 for dwellings requiring moderate rehabilitation. The first-year subsidies are expected to average about $2,200 and $3,100 per unit, respectively.[6] Outlays on behalf of the nearly one million households expected to be receiving aid in 1982 will total about $1.9 billion.

Public Housing

The public housing program, first authorized in 1937, also serves lower-income renters. Under this program, HUD pays the full development and financing costs--principally through tax-exempt bonds and notes--for newly built or rehabilitated projects that are owned by local housing agencies and made available to lower-income families at rental charges comparable to those paid by Section 8 tenants. In addition to paying all debt-service costs, for each of the past several years the federal government has also paid a share of the operating expenses for most projects. As with the Section 8 existing-housing program, local agencies managing public housing projects must ration aid among qualifying applicants.[7]

Approximately 1.4 million public housing subsidy commitments were outstanding at the end of fiscal year 1981. An additional 24,000 housing units could be built with funds available in 1982. Annual debt-service costs for the newly assisted dwellings are likely to exceed $6,000 per unit.[8] Most newly assisted units will

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6. Figures exclude administrative fees paid to local agencies.

7. For a description of how agencies select public housing tenants, see Raymond J. Struyk and Jennifer L. Blake, Determining Who Lives in Public Housing (The Urban Institute, March 1982).

8. The difference in expected subsidy costs between public housing and Section 8 new construction assistance commitments may reflect in part some difference in the mix of households (Continued)

also eventually require operating subsidies, which are expected to average about $1,000 per unit for all dwellings available for occupancy in 1982. Direct expenditures associated with the 1.2 million public housing units available for occupancy in 1982 are expected to total more than $2.8 billion--nearly $1.6 billion for debt-service expenses and just under $1.3 billion for operating subsidies.

Section 235 Homeownership Assistance

The Section 235 homeownership assistance program, also administered by HUD, provides annual mortgage interest subsidy payments on behalf of low- and moderate-income persons buying newly built or substantially rehabilitated homes. First authorized in 1968, the Section 235 program aids households with incomes below 95 percent of the area median, generally limiting their mortgage principal and interest payments plus property taxes to 20 percent of their incomes. Initially the program assisted principally low-income homebuyers, reducing their effective mortgage interest rates to as low as 1 percent. After experiencing high default rates, however, that form of the program was suspended in 1973. When reinstated two years later, assistance was targeted on households with incomes nearer the eligibility ceiling and the minimum effective interest rate was raised--reaching 8 percent for the most recently assisted households. In 1980, another program variant was authorized--but not funded--to provide more limited subsidies as a countercyclical housing stimulus device.

Although no new funds have been provided since fiscal year 1981 to finance additional Section 235 assistance commitments, previously appropriated funds are expected to be sufficient to aid approximately 15,000 additional homebuyers in 1982. About $285 million are expected to be expended in 1982 to cover the 260,000 households receiving aid as a result of past agreements.

Farmers Home Administration Programs

The Farmers Home Administration (FmHA)--an agency of the Department of Agriculture--provides homeownership and rental

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8. (Continued)
served, with public housing expected to aid larger households on average, thus requiring larger units and, therefore, higher average development costs.

assistance to lower-income rural residents, principally through reduced-interest loans.[9]

Homeownership Loans. Under the Section 502 program, first authorized in 1949, the FmHA makes reduced-interest loans to lower-income families purchasing modest-priced homes. Families with adjusted incomes no greater than 80 percent of the area median--$11,500 to $18,000 within the continental United States for areas served by the FmHA--may qualify for mortgages with effective interest rates as low as 1 percent, limiting their total mortgage payments, property taxes, and insurance costs to 20 percent of their incomes. Households with incomes up to $5,500 above those levels may receive fixed-rate loans at interest charges approximating federal long-term borrowing costs--generally a few percentage points below prevailing private mortgage interest rates.

At the end of fiscal year 1981, $19.2 billion in Section 502 loans were outstanding, covering about 960,000 borrowers. In 1982, an additional 67,500 families are expected to receive $2.7 billion in Section 502 loans at an estimated average annual interest rate of 5 percent or less. The interest-subsidy cost for all outstanding Section 502 loans is expected to total $1.2 billion during 1982.

Rental Housing Assistance. The FmHA provides rental housing assistance through a combination of reduced-interest project loans and supplementary rental assistance payments. The Section 515 loan program--first authorized in 1962--provides 1-percent-interest mortgages to nonprofit and limited-profit organizations and state and local governments to finance the construction of rental projects for low- and moderate-income households, the elderly, and handicapped individuals. Supplementary rental assistance payments--similar to those provided through Section 8--further reduce housing costs for some of the lowest-income tenants, limiting their out-of-pocket housing expenses to 25 percent of their incomes.[10]

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9. For a more complete description of FmHA housing programs and their costs, see Congressional Budget Office, Rural Housing Programs: Federal Costs and Budget Treatment (June 1982).

10. Under an agreement between the departments of Agriculture and Housing and Urban Development, Section 8 assistance has also (Continued)

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By the end of 1981, Section 515 loans had been written covering approximately 250,000 housing units, and commitments had been made to provide supplementary rental assistance to 81,000 of those households. Section 515 loans covering an additional 29,000 housing units are expected to be obligated in 1982, and 14,000 new or extended commitments are expected to be funded under the rural rental assistance payments program. Interest-credit and rental assistance expenses for those households receiving aid in 1982 are expected to total about $423 million during that year alone.

Section 312 Rehabilitation Loans

The Section 312 program, first authorized in 1964, provides subsidized loans to homeowners and landlords to finance the rehabilitation of properties requiring significant repairs to be brought up to local code standards. Under the Section 312 program, HUD allocates funds to local housing agencies that make reduced-interest loans to owners of properties located in areas designated to receive concentrated public investment. Most loans go to homeowners with incomes less than 95 percent of the area median and to owners of multifamily rental properties located in low- and moderate-income neighborhoods or in which a majority of the initial tenants will have incomes below 95 percent of the area median. Until 1982, all Section 312 loans were written at interest rates of 3 percent. Beginning this year, while 3-percent-interest loans will continue to be offered to homeowners with incomes below 80 percent of the area median, higher-income homeowners will be charged 11 percent. Also beginning in 1982, loans to finance repairs to multifamily structures will be written at interest rates of either 5 or 11 percent, depending on the degree of private financial contribution.

Lending under the Section 312 program has fluctuated widely in recent years, reaching a peak of $225 million in 1979--enough to finance repairs to 21,000 housing units. Fiscal year 1982

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10. (Continued)
been provided for a share of each year's Section 515-financed projects. For Section 515/Section 8 projects, the interest rate charged on the FmHA loan is generally only one to two percentage points below average long-term federal borrowing costs, thus requiring larger rental assistance payments than are needed for 1-percent-interest projects that receive supplementary rental aid through the FmHA.

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lending will be limited to funds available through loan repayments--currently estimated at about $68 million, sufficient to finance repairs to approximately 700 single-family homes and about 4,500 units in multifamily structures.

Federally Funded Community Development Programs

In addition to providing housing aid directly, the federal government also funds locally designed and administered programs through the Community Development Block Grant and Urban Development Action Grant programs.

Community Development Block Grants (CDBG). The CDBG program--administered by HUD--provides relatively unrestricted assistance to all metropolitan cities and urban counties on an entitlement basis and to many smaller cities through competitive grants. Although program rules prohibit the use of CDBG funds to subsidize new residential construction, housing rehabilitation is permitted and has consumed a growing share of funds since the program's inception in fiscal year 1975. By 1981, about 36 percent of all spending by entitlement jurisdictions was expected to be devoted to residential rehabilitation, making it the largest single activity funded under the CDBG program.[11] Applying that proportion to the 1982 appropriation of $3.5 billion, approximately $1.3 billion in CDBG funds may be expected to be devoted to rehabilitation this year--sufficient to support the upgrading of approximately 225,000 housing units. Most CDBG-funded programs provide grants or reduced-interest loans to low- and moderate-income homeowners to subsidize moderate rehabilitation.

Urban Development Action Grants (UDAG). A sizable proportion of the funds provided to localities through the Urban Development Action Grant (UDAG) program are also used to finance housing assistance. Under the UDAG program--initiated in fiscal year 1978--HUD awards grants to distressed cities and to other jurisdictions where there are pockets of poverty to support joint public-private redevelopment projects. About one-fourth of all UDAG projects approved during the first four program years involved either the construction of new housing or the upgrading of existing units, with the emphasis shifting over time toward

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11. U.S. Department of Housing and Urban Development, Consolidated Annual Report to Congress on Community Development Programs (April 7, 1982), pp. 29-30.

rehabilitation. About one-half of all UDAG-assisted units are expected to be occupied eventually by low- and moderate-income households, with the trend moving toward less income targeting from the first to the fourth program year.[12] If housing aid represents the same proportion of current-year UDAG efforts, the 1982 appropriation of $440 million could support the construction or upgrading of about 10,000 dwellings.

THE BUDGET TREATMENT OF PRESENT PROGRAMS AND OUTSTANDING ASSISTANCE COMMITMENTS

The principal federal housing assistance programs are funded through annual authorizations and appropriations that provide specified amounts of long-term spending authority or loan authority to fund additional subsidy commitments. For each of the last few years, the Congress has also specified what the funding mix should be, first, between HUD's new construction and existing-housing rental assistance programs, and, second, between FmHA low-income and moderate-income rural housing programs. Currently, the mix between FmHA homeownership and rental assistance is set administratively by the Department of Agriculture.

In recent years, the number of commitments made annually under HUD's rental assistance programs has declined from a high of more than 500,000 in fiscal year 1976 and the three months following to about 200,000 in each of the last few years (see Table 5). HUD currently expects to fund just over 200,000 subsidy commitments in 1982, if all available spending authority is used. Under the Department's present spending plan, however, more than half of those commitments will represent conversions from one form of assistance to another, rather than net additions to the number of households aided. Through 1980 the program mix was set by HUD, based in part on the preferences of local governments; during that period, the reliance on new construction and substantial rehabilitation increased. In the last few years, however, the program mix has been set partially by law and has shifted back to a greater emphasis on existing-housing assistance. The number of additional FmHA assistance commitments made annually has also declined somewhat over the last several years. During that time, rental assistance has grown as a share of all rural housing aid, and available assistance has been increasingly targeted on low-income persons.

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12. Ibid., pp. 72-73.

TABLE 5. NUMBER OF ASSISTANCE COMMITMENTS MADE ANNUALLY AND PROGRAM MIXES UNDER HUD AND FmHA HOUSING ASSISTANCE PROGRAMS: FISCAL YEARS 1976-1982

Program	1976[a]	1977	1978	1979	1980	1981	1982 (est.)[b]
HUD Rental Assistance Programs (Section 8/Public Housing)							
Assistance commitments made (in thousands)[c]	517	388	326	325	206	178	202[d]
Percent distribution:							
New construction/substantial rehab.	39	52	55	61	63	43	35
Existing-housing/moderate rehab.	61	48	45	39	37	57	65
FmHA Homeownership and Rental Housing Loans							
Assistance commitments made (in thousands)	164	139	135	132	115	99	97
Percent distribution:							
Homeownership assistance	81	77	75	71	71	70	70
Rental assistance	19	23	25	29	29	30	30
Low-income	68	70	72	78	83	91	88
Moderate-income	32	30	28	22	17	9	12

SOURCES: HUD and FmHA budget documents.

a. Includes transition quarter between July-to-July and October-to-October fiscal years.

b. Estimates assume the use of all funding provided in appropriations acts passed during the first session of the 97th Congress plus budget authority carried over from 1981.

c. Figures for 1976-1981 are additional assistance commitments made net of deobligations during the same year. Figure for 1982 represents gross additional commitments.

d. Includes 117,000 conversions of already assisted dwellings to Section 8 existing-housing assistance.

Largely as a result of commitments made during the last decade, about 4 million rental assistance commitments and 1.3 million homeownership commitments will be outstanding at the end of fiscal year 1982 (see Table 6). The rental assistance commitments will be sufficient to serve only 11 percent of all households with incomes below 80 percent of the area median--the eligibility limit for most rental assistance. However, those commitments will be sufficient to serve 22 percent of all income-eligible renters and about 28 percent of all renters with incomes below 50 percent of the area median--the effective target group of present programs. Outstanding homeownership assistance commitments will be sufficient to serve only 3 percent of all households with incomes below the eligibility limits for such aid, or 6 percent of all homeowners with incomes low enough to qualify.

Long-term obligations under all HUD rental and homeownership assistance commitments expected to be outstanding at the end of fiscal year 1982 will total more than $240 billion.[13] Interest-subsidy costs and rental assistance payments under outstanding FmHA subsidy agreements will probably add several billion dollars to this total. Actual long-term expenditures will depend on housing costs, interest rates, and household incomes for many years to come.[14]

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13. Obligation under HUD programs represents the total unspent budget authority set aside to fund all assistance commitments expected to be outstanding as of the end of fiscal year 1982. The figure excludes future requirements for public housing operating subsidies.

14. For descriptions of expected long-term costs under alternative economic assumptions, see Congressional Budget Office, The Long-Term Costs of Lower-Income Housing Assistance Programs (March 1979) and Rural Housing Programs: Federal Costs and Budget Treatment (June 1982).

TABLE 6. NUMBER OF ASSISTANCE COMMITMENTS OUTSTANDING THROUGH FISCAL YEAR 1982 AND PROPORTION OF THE ELIGIBLE POPULATION SERVED UNDER CURRENT HOUSING ASSISTANCE PROGRAMS (In millions of households)

	Rental Assistance[a]	Homeownership Assistance[b]
Number of Commitments Outstanding	4.0	1.3
Estimated Number of Income-Eligible Households--Renters and Homeowners Combined[c]	37.2	44.6
Estimated Number of Income-Eligible Households in Same Tenure Class--Renters or Homeowners Alone[c]	18.6	23.5
Outstanding Commitments		
As percent of all income-eligible households[c]	10.8	2.9
As percent of all income-eligible households in same tenure class[c]	21.5	5.5
As percent of all very-low-income households in same tenure class	27.8[d]	NA

SOURCE: CBO estimates. NA = Not available.

a. Includes Section 8, public housing, Section 236, rent supplement, and FmHA rental assistance programs.

b. Includes outstanding Section 235 homeownership assistance commitments and FmHA homeownership loans.

c. Eligibility limit for rental assistance is 80 percent of area median family income for a family of four. Limit for homeownership assistance is 95 percent of area median.

d. Estimated number of assistance commitments serving renters with incomes no greater than 50 percent of area median as a percent of all such households.

CHAPTER IV. ALTERNATIVE APPROACHES

The high cost of current housing assistance programs and their limited coverage has prompted a growing interest in alternative approaches for providing housing aid. This chapter examines several comprehensive policy alternatives that have been suggested recently and that have been under active consideration during the current session of Congress. The next chapter discusses program-design issues associated with each approach.

COMPREHENSIVE POLICY ALTERNATIVES

One obvious option available to the Congress would be to cease making additional housing assistance commitments. In light of the significant improvement in housing conditions that has occurred over the past several decades and the fact that remaining housing problems for the poor have more to do with the cost of housing than with its quality, some persons have argued that additional assistance tied specifically to housing may no longer be necessary. If such an approach was adopted, the current inventory of assisted units would still be available for lower-income persons, but any further assistance that might otherwise have gone for housing aid would be used instead to provide general income assistance to the poor. Taken one step further, outstanding housing assistance commitments could be gradually phased out, and the funds thus made available could be devoted to general income support programs as well. In either form, this alternative would do little to improve the housing conditions of those lower-income families who remain ill-housed, but would allow available resources to aid a larger number of low-income households and would grant assisted households greater freedom in the use of their additional income.

If the Congress chooses, instead, to continue to expand housing assistance for the poor, alternatives to present programs include:

- Housing vouchers;
- Housing assistance block grants; and

- o A multiple-program approach involving separate lower-income assistance and production-subsidy programs.

Each of these three alternatives is discussed below.[1]

Housing Vouchers

One alternative to current programs would be to provide any additional housing assistance principally through cash or cash-equivalent vouchers paid directly to lower-income persons living in physically standard rental housing of their own choosing in the private market. Under most voucher proposals, assisted households would receive payments equal to the difference between some percentage of their income and a benchmark amount corresponding to the estimated cost of modest-priced, physically standard housing. Households renting units costing more than the benchmark amount would pay the full additional expense themselves; those choosing to live in less costly dwellings would realize all of the savings. In either case, vouchers could only be used for dwellings meeting minimum quality standards.

Housing vouchers would closely resemble Section 8 existing-housing assistance and could be implemented by making a limited number of statutory changes. There are three principal differences between the present existing-housing program and the voucher program described above (see Table 7).[2] First, under a

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1. The Administration's budget and legislative proposals for fiscal year 1983 incorporate elements of the first two alternatives. The Administration has proposed that beginning in 1983 additional HUD lower-income rental assistance commitments be funded principally through a modified Section 8 existing-housing certificate program, which would resemble a housing voucher program in several important respects. The Administration has also proposed that rental rehabilitation grants be provided to states and localities, in part to help finance repairs to some of the units occupied by households assisted under the certificate program. The Administration's proposal calls for financing its 1983 assistance commitments principally with funds recaptured through the deobligation of outstanding tentative new construction, substantial rehabilitation, and moderate rehabilitation commitments.

2. The voucher alternative described here is based on the primary program design assessed in the HUD-sponsored Experi-

(Continued)

TABLE 7. PRINCIPAL DIFFERENCES BETWEEN HOUSING VOUCHERS AND SECTION 8 EXISTING-HOUSING PROGRAM

Section 8 Existing-Housing	Housing Vouchers[a]
Nature of Payment	
Payment made to landlord on behalf of assisted household. Requires contract between administering agency and landlord.	Payment made directly to assisted household. No contract with landlord required.
Rent/Subsidy Limit	
Maximum allowable rent levels limit households' housing choices and size of subsidy.	No maximum rents apply. Subsidy cap limits federal expenditure but households may choose any physically standard unit.
Size of Subsidy	
Subsidy equals difference between full market rent on occupied unit and fixed percentage of tenant income. Subsidy varies both with household income and with market rents on occupied units.	Subsidy equals difference between subsidy cap and fixed percentage of tenant income. Subsidy varies only with household income.

a. The voucher alternative described here is the primary program design assessed in the Experimental Housing Allowance Program.

voucher program, payments would be made directly to assisted households rather than to their landlords. Second, a subsidy limit would replace the rent limit, thus expanding participants' housing choices. Third, the size of the subsidy would not vary with a unit's market rent level, thereby providing a stronger incentive for recipients to shop for the least costly housing available.[3] Because of the similarities between the two programs, housing vouchers could easily be administered locally by the same agencies now providing Section 8 existing-housing assistance.

Housing Assistance Block Grants

A second policy alternative would involve folding current housing assistance programs into one or more block grants to be spent by state and local governments under programs of their own design.[4] In its most inclusive form, all current direct assistance programs--including Section 8, public housing, Section 235, FmHA loan programs, and the Section 312 rehabilitation program--would be folded into a single loosely restricted grant. A more limited block grant might supplant only particular types of programs while restricting the use of funds to corresponding types of assistance.

Any block grant would place a high premium on local discretion in determining what housing needs should be addressed. Such an approach presupposes that smaller units of government--because of their greater knowledge of local conditions--would be better

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3. (Continued)
mental Housing Allowance Program (EHAP), a 12-market study begun in 1971 to measure the costs and impacts of housing vouchers. Much of what is known about the likely effects of a national voucher program comes from EHAP, which is now nearing completion. The EHAP reports cited in this study represent only a small share of all those that are available.

3. Each of these features of a voucher program is discussed in greater detail in Chapter V.

4. For a discussion of specific housing assistance block grant proposals, see John C. Weicher, "Housing Block Grants," Staff Background Paper prepared for the Committee on Federal Housing Programs and Alternatives of The President's Commission on Housing (August 26, 1981).

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able than the federal government to identify local needs and to devise strategies for dealing with them. Without federal guidelines, however, a housing block grant would necessarily substitute local judgments for national ones concerning the targeting of assistance.

A comprehensive housing assistance block grant would represent a major break with the past by turning over to state and local governments the responsibility for assisting lower-income renters and for promoting new residential construction. A more limited block grant emphasizing housing rehabilitation would more closely resemble the Community Development Block Grant program, and would therefore constitute a less dramatic policy shift.

Multiple Program Approach

A third option--encompassing elements of the other two--would be to use separate programs to pursue separate policy objectives. Under one such scheme, housing vouchers would be used to aid lower-income renters; a limited-use block grant would fund complementary rehabilitation assistance; and a separate production subsidy would be relied upon to promote the construction of new rental housing that would be available to households over a wider income range than would be served by vouchers. A somewhat different form of this proposal would entail subsidizing new residential construction as well as rehabilitation through block grants.

In either form, such an approach would direct lower-income aid toward reducing the housing costs of the poor while dealing separately with housing quality and supply concerns. Using different policy tools to address distinct concerns could increase overall efficiency. Applying this approach, it could be possible, for example, to aid more lower-income persons while subsidizing the construction or rehabilitation of more housing units at less expense than pursuing both objectives through current lower-income new-construction/rehabilitation programs. On the other hand, any system that included a production subsidy targeted less toward low-income households would necessarily divert some funds from the lowest-income persons in order to help provide additional housing for those who are better off.

The principal elements of a multiple-program approach would likely resemble existing programs and could, in fact, be modeled on them. Housing vouchers could be offered through a slightly revised Section 8 existing-housing program. A limited-use block

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grant could be created by setting aside a portion of CDBG funds--one-third of which are already used for housing rehabilitation--or by authorizing a separate program. A rental housing production subsidy could be provided by adapting any of several devices now used to reduce financing charges on Section 8 projects; by making new residential construction an eligible activity under the CDBG program; or by designing an entirely new alternative.[5]

ASSESSING ALTERNATIVE APPROACHES

Current housing assistance programs and the alternatives outlined above differ with respect to:

- The policy objectives addressed;
- The population that would be assisted;
- Program costs; and
- The ease of administration and the level of government at which administrative decisions would be made (Table 8).

Policy Objectives Addressed

Present housing assistance programs pursue the objectives outlined in Chapter II through numerous overlapping policy devices, each of which is generally meant to serve more than one goal. Multiple objectives are particularly evident in current new construction programs that are designed to improve the living conditions and reduce the housing costs of lower-income persons while simultaneously promoting new housing production.

Primary or exclusive reliance on housing vouchers would concentrate federal resources more narrowly on alleviating housing-cost burdens among the poor. Findings from the HUD-sponsored Experimental Housing Allowance Program and experience under the Section 8 existing-housing program indicate that vouchers would also likely induce some upgrading of marginally substandard units but would probably not generate repairs to many seriously dilapidated

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5. Specific subsidy options are discussed in Chapter V.

TABLE 8. COMPARISON OF ALTERNATIVE HOUSING ASSISTANCE APPROACHES

Policy Alternative	Objectives Served	Types of Households Assisted	Average Cost per Household Assisted[a]	Administrative Burden and Degree of Local Discretion
Current Housing Assistance Programs	Principally aiding lower-income households and supporting new residential construction.	Principally very-low-income renters.	3,650	Administrative burden varies with program. Localities exercise some control over program mix.
Housing Vouchers	Principally aiding lower-income households.	Exclusively very-low-income households.	2,150	Administrative burden light. Local discretion limited.
Housing Assistance Block Grants	Depend on federal guidelines and local program-design decisions.			Federal involvement diminished. Local responsibilities and discretion increased.
Multiple-Program Approach				
Lower-income housing vouchers; separate block grants or production subsidies to support rehabilitation or construction.	Similar to current programs but different policy tools used to address different objectives.	Very-low-income households through vouchers. Somewhat higher-income persons through production subsidy.	2,150 per voucher recipient. Production subsidy cost depends on program design.	Depend on program design.

a. Figures represent estimated direct expenditures in constant dollars for the first year of assistance per additional assistance commitment made in 1983. Estimated average cost under current programs assumes 55 percent existing-housing assistance and 45 percent new construction mix--the program mix expected to result from the fiscal year 1982 authorizing legislation at the time it was enacted. See accompanying text for description of specific voucher option.

structures or promote additional residential construction.[6] Available evidence suggests that vouchers might also contribute somewhat to racial and economic deconcentration but that the degree of geographic dispersion would probably be very limited.[7] There is no evidence that a voucher program would have any measurable inflationary effect on rents, even in a relatively tight

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6. In the two largest housing allowance sites, about three-fifths of all renters enrolling in the program who were initially living in dwellings that failed inspections upgraded their units at an average expense of less than $40, excluding the value of donated labor. The proportion of initially inadequate units that were eventually upgraded ranged from 70 percent of all units that failed only one inspection item to 32 percent of the units failing on four or more counts. Over time, the requirement that recipients' dwellings remain up to standard appears to generate improved maintenance, with one-fourth to two-fifths of all eventually qualifying rental units failing annual reinspections and more than 70 percent of those being brought back up to standard. See James L. McDowell, Housing Allowances and Housing Improvements: Early Findings (The Rand Corporation, September 1981); and Sinclair B. Coleman, How Enrollees Respond to Allowances and Housing Standards (The Rand Corporation, forthcoming).

7. A study of the Section 8 existing-housing program in 15 metropolitan areas found that assistance recipients who moved relocated from census tracts with an average of 12 percent of all households in poverty to tracts in which an average of 10 percent of all households were poor. Minority-headed Section 8 households who moved relocated from tracts with an average of 50 percent minority-headed households to tracts with an average of 39 percent minority-headed households. See James E. Wallace and others, Participation and Benefits in the Urban Section 8 Program (Abt Associates, Inc., January 1981), pp. 247 and 261. Findings from the housing allowance experiments reported somewhat smaller degrees of deconcentration and, in general, found that the locational choices of assistance recipients did not differ appreciably from those of low-income renters who did not receive aid. See Fourth Annual Report of the Housing Assistance Supply Experiment (The Rand Corporation, May 1978); and Stephen D. Kennedy, The Final Report of the Housing Allowance Demand Experiment (Abt Associates, Inc., June 1980).

housing market, largely because vouchers do not generate substantial additional housing demand.[8]

The policy goals emphasized under a comprehensive housing assistance block grant would depend on the federal guidelines established and on the program-design decisions made locally. The relative emphasis given the housing affordability and housing adequacy problems of the poor, for example, would depend on the distribution of assistance among existing-housing, rehabilitation, and new-construction programs.

Combining housing vouchers with a rental housing production subsidy that assisted persons over a wider income range would use different devices to serve some of the same goals addressed by current programs. Differentiating between lower-income assistance and construction support, however, would increase the efficiency of the system as a whole--making it possible either to aid lower-income households or to subsidize new production without paying the large price needed to make the newly built structures immediately accessible to very-low-income persons.

The Population Assisted

As noted earlier, most aid under current housing assistance programs benefits very-low-income renters. While present rental assistance programs are open to families with incomes up to 80 percent of the area median, recent legislation required that at least 90 percent of all future beneficiaries have incomes no greater than 50 percent of the area median. Present tenant incomes are already heavily concentrated below the lower threshold, averaging about $4,800 as of 1979, or approximately 25 percent of the median family income.

Housing vouchers would target aid exclusively on very-low-income persons, because the subsidy cap would probably be set at a

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8. When offered on an entitlement basis over a three-year period to both homeowners and renters in two quite different markets, housing allowances, or vouchers, increased the aggregate demand for housing by less than 2 percent with no perceptible marketwide effect on either rents or property values. See Ira S. Lowry, Experimenting with Housing Allowances: Executive Summary of the Comprehensive Final Report of the Housing Assistance Supply Experiment (The Rand Corporation, April 1982).

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level at which families with incomes above 50 percent of the median would not qualify or would be eligible only for small payments.[9] Within the very-low-income population, aid would likely be still further concentrated in the lowest-income segment, because the smaller maximum subsidy would provide less incentive for better-off persons to join.

The population served under a comprehensive housing assistance block grant would depend on federal guidelines and on local program-design decisions. Evidence from current community development programs suggests, however, that without fairly stringent federal targeting requirements aid might be dispersed across a somewhat wider income range than under current housing programs.[10] Also, under an unconstrained housing block grant, funds now used to assist renters might be diverted to homeowners, who, as a group, are less likely to be living in physically inadequate dwellings and are generally better able to finance their own housing improvements.

Under a multiple-program approach, different programs would serve different income groups. As noted, housing vouchers would aid exclusively very-low-income households. Depending on program restrictions, supplementary block grants might assist the same households or could be designed to aid persons ineligible for

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9. The manner in which this automatic targeting would occur, and options for setting income eligibility thresholds for a voucher program, are discussed further in Chapter V.

10. According to a 1976 survey, about 20 percent of the homeowners receiving assistance under CDBG-funded housing rehabilitation programs had incomes above the eligibility threshold for Section 8 and public housing assistance. Three-fifths of all homeowners benefiting from CDBG-funded housing rehabilitation assistance would have qualified as very-low-income under housing assistance program definitions, compared to nearly 90 percent of all Section 8 and public housing recipients. As noted earlier, only about one-half of the eventual occupants of housing projects built or rehabilitated with UDAG funds are expected to be lower-income persons. See U.S. Department of Housing and Urban Development, Community Development Block Grant Program: Third Annual Report (March 1978), pp. 136-37; and Consolidated Annual Report to Congress on Community Development Programs (April 7, 1982).

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vouchers. A separate rental housing production subsidy would almost certainly serve better-off persons, because the subsidy provided would probably be insufficient to make newly built housing readily affordable to low-income families.

Program Costs

The costs of current housing assistance programs vary widely, depending principally on the types of structures in which people are housed. The average annual direct federal expenditure for rental assistance commitments made in fiscal year 1983 would range from about $2,350 per family aided under the Section 8 existing-housing program to more than $5,000 per household assisted under the new-construction programs. If the initially anticipated 1982 program mix of 55 percent existing-housing/moderate rehabilitation and 45 percent new-construction/substantial rehabilitation was repeated for 1983 as well, the average annual direct expenditure per additional household aided in that year would be $3,650.[11]

Housing vouchers would be appreciably less costly than the current mix of housing aid and might even be less expensive than Section 8 existing-housing assistance. The savings relative to Section 8 existing-housing could occur because a voucher program would replace the Section 8 rent maximums with payment standards, making it possible to set the payment standards at lower levels as a means of reducing program costs without automatically foreclosing additional segments of local housing markets from assisted households. Any reduction in the payment standards would, however, increase the share of their nonvoucher income that assisted households would have to pay to afford dwellings renting for more than the benchmark levels. Thus, while reductions in the payment standards would not automatically foreclose beneficiaries' housing choices, such reductions could make some share of local housing markets financially inaccessible to assistance recipients. If the payment standards were set 5 percent below the projected 1983 Section 8 existing-housing rent maximums, for example, the average annual cost per household aided in that year would be $2,150, or about 8 percent lower than the average cost of aiding a comparable

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11. All figures are estimates of the constant fiscal year 1983 dollar cost for the first year in which the newly assisted dwellings would be occupied.

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household under the Section 8 existing-housing program and 40 percent less than the average expense under the current program mix.[12]

The average expenditure per household aided under a block grant program would depend on the types of assistance provided locally and the income groups served. In whatever form aid was provided, some administrative savings would likely be realized at the federal level. By contrast, state and local administrative expenses might increase--at least in the short run--as they took over additional program-design and management responsibilities.

The cost of any rental housing production subsidy designed to supplement lower-income vouchers would depend on the size of the subsidy provided and on the subsidy mechanism used. Using a mortgage assistance grant to reduce the financing charges on a newly built rental unit with a $50,000 mortgage from a market rate of, say, 15 percent to 12 percent, for example, would require a one-time expenditure of $9,400. Reducing the effective interest rate by seven percentage points would cost $21,500. Averaged over the expected lives of the loans, annual constant-dollar expenditures would range from $500 per unit for a three-percentage-point subsidy to $1,100 per unit for a seven-percentage-point interest

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12. In this example, the average payment standard for the voucher program is assumed to be set at slightly more than $3,600 on an annual basis, or about $300 per month. This level is close to the average expected Section 8 existing-housing Fair Market Rent (FMR) or rent ceiling for assistance commitments to be entered into in 1982, but it is somewhat less than what the FMR would be in 1983 if it was increased from 1982 at a rate sufficient to take account of anticipated growth in housing costs between the two years. As part of its legislative proposals for this year, the Administration has recommended replacing the present Section 8 existing-housing rent ceilings with payment standards for newly assisted households. The Administration has indicated that they expect to fix the market-specific payment standards equal to about the 40th percentile of all rents on physically adequate dwellings, excluding newly built units. This compares with present Section 8 existing-housing FMRs equal to the 50th percentile of all rents on units occupied by recent movers and anticipated fiscal year 1982 FMRs equal to the 40th percentile of all rents paid by recent movers. It is estimated

(Continued)

subsidy.[13] Regardless of how large an interest-rate reduction was provided, a rental housing financing subsidy of this sort would be appreciably less costly than current lower-income new construction programs but would benefit principally better-off persons.[14] If subsidized projects were used to house large numbers of very-low-income tenants, either supplementary rental assistance would be required--appreciably increasing total program costs--or the poorer tenants would have to pay much larger shares of their incomes toward housing than they do under present lower-income assistance programs.

Ease of Administration and Local Discretion

The present set of federal housing programs requires that state and local governments and housing developers learn the operating details of numerous program variants, and probably confuses many households seeking aid. Under the current system, localities are granted some discretion in determining the mix of housing assistance programs offered within their jurisdictions. For each of the last few years, however, the Congress has specified the nationwide division of funds between new construction and existing-housing assistance.

Providing housing aid primarily or exclusively through vouchers might reduce local administrative burdens, but would also diminish discretion by reducing the number of available subsidy devices. On the other hand, under a voucher program funds could be allocated directly to smaller jurisdictions than under present new-construction programs, because under a voucher system there

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12. (Continued)
that shifting from the 1981 benchmarks to the proposed 1983 levels would reduce the FMRs/payment standards by about 15 percent, after adjusting for housing cost increases over that two-year period.

13. Figures assume an average effective life of 20 years on a 40-year mortgage.

14. As discussed further in Chapter V, the net federal expense of a rental housing subsidy could be reduced by requiring that project owners repay some part of their subsidies when they dispose of their properties.

would be no concern regarding what minimum allotment of funds would be needed to support a feasible housing project.

Block grants would maximize local discretion but could also increase state and local administrative burdens, particularly in the early program years as those goverments took on additional program-design and management tasks. A block grant could also increase the burden on developers, financial intermediaries, and others involved with the production of housing who might have to learn the operating details of many different locally designed programs.

The administrative burden and degree of discretion associated with any multiple-program approach would largely depend on the design of the individual elements and on the nature of any mechanism that might be employed for coordinating the component programs. The administrative burden associated with a separately administered new-construction financing subsidy, in particular, would depend primarily on the degree of continuing federal oversight of assisted projects after construction was complete.

CHAPTER V. PROGRAM-DESIGN ISSUES AND OPTIONS

If the Congress adopts any of the policy alternatives discussed in the preceding chapter, it will also have to resolve numerous issues associated with the design of the programs. This chapter discusses issues and options likely to arise in designing vouchers, block grants, and production subsidies.

HOUSING VOUCHER ISSUES AND OPTIONS

Issues to be resolved in designing a voucher program--or in amending the Section 8 existing-housing program to resemble more closely a voucher approach--include:

- Who should be eligible to receive aid and how assistance should be rationed locally;
- Whether to establish maximum rent levels;
- Whether payments should be made directly to households or--in the case of renters--to their landlords; and
- How the program should be funded.

Household Eligibility and Rationing of Aid

Eligibility for housing vouchers could be limited by household income and by tenure (that is, whether the family rents or owns its dwelling). In general, the more inclusive the eligibility criteria the less the aid would be targeted toward those most in need and the smaller would be the proportion of the eligible population that could be served at any given level of federal expenditure. Whatever eligibility limits were established, however, federal budget constraints make it highly unlikely that all eligible households could be served in the immediate future. For this reason it would be necessary to continue rationing aid at the local level.

Income Limits. By its very nature, a housing voucher program would be targeted on very-low-income households. Assuming an average annual payment standard or subsidy cap of $3,600 and an expectation that tenants contribute 30 percent of their adjusted income toward their own housing expenses, no family subject to that payment standard who had an adjusted annual income greater than about $12,000 could qualify for aid. Put differently, at that income level--corresponding to just under 50 percent of the projected 1983 median family income for the nation as a whole--the voucher payment to which a family would be entitled would drop to zero, because 30 percent of the family's adjusted income would exceed the payment standard.

Because eligibility for vouchers would be automatically limited in this manner, one option available to the Congress would be to make anyone qualifying for a non-zero payment eligible, subject to the appropriation of funds. If this approach was adopted, eligibility would vary across local markets because of differences in housing costs. Also, the eligibility limits would be adjusted automatically whenever the market-specific payment standards were changed. Applying this approach, and assuming an average payment standard of $3,600, approximately 11.2 million renters would be eligible for vouchers in 1983. About 3.2 million of those households could already be aided under current rental assistance programs, leaving 8 million households currently unserved.[1]

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1. Under any voucher program, the number of households who would seek aid or eventually qualify for payments would probably be appreciably smaller than the number of those eligible. In two EHAP sites in which open-enrollment voucher programs were operated, about two-thirds of all eligible renters were enrolled at some time during the first three program years, and approximately one-half of all eligible renters actually received assistance payments at some time during that period. As of the end of the third program year, 45 percent of all eligible renters in one site and 38 percent of all eligible renters in the other site were receiving payments. Initial occupancy of physically inadequate housing and low potential benefits accounted for most failures by eligible households to qualify for payments. See Ira S. Lowry, Experimenting with Housing Allowances: Executive Summary of the Comprehensive Final Report of the Housing Assistance Supply Experiment (The Rand Corporation, April 1982). Based on these participation rates, some have argued that a nation-

(Continued)

Another option would be to limit eligibility to households with incomes below some percent of the area median family income, as is currently done under the Section 8 and public housing programs. Because eligibility would already be limited in the manner described above, however, if the average payment standard was set at about $3,600, any eligibility limit much greater than about 50 percent of the area median would be largely redundant. Eligibility limits below that level would target aid on a smaller population but could also create a benefit "notch," whereby someone with an income one dollar below the eligibility limit might qualify for a sizable payment and thus be better off than a neighbor earning one dollar above the limit. Also, under such a system, better-off persons living in wealthier areas might be eligible for assistance while less-well-off persons living in poorer jurisdictions would be ineligible. If this general approach was used to establish eligibility limits, the Congress might, therefore, choose either to place some absolute dollar income limit on eligibility nationwide or to establish somewhat higher percent-of-area-median limits for persons in the lowest-income localities.

If this approach was adopted and eligibility limits were set at 40 percent of the area median family income approximately 8.8 million rental households might be eligible for vouchers in 1983. About 2.8 million of those households could be assisted under current programs, leaving 6 million families yet to be served.

Tenure Restrictions. Although vouchers are generally viewed as a mechanism for aiding renters, they could also be used to assist homeowners. Findings from the housing allowance experiments show that a voucher program for homeowners would involve few additional administrative requirements and might generate greater housing improvements than comparable assistance to renters.[2] On

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1. (Continued)
wide entitlement voucher program could be obtainable in the near future, although still at a substantial increase in federal expenditures. By one estimate, moving to an entitlement voucher program in the 1980s would require about $7 billion in additional outlays per year. See Jill Khadduri and Raymond J. Struyk, Housing Vouchers: From Here to Entitlement (The Urban Institute, December 1980).

2. When given the opportunity to participate in a voucher program, eligible homeowners enrolled at a lower rate than (Continued)

the other hand, assisting homeowners as well as renters would nearly double the number of eligible households. This would dilute available assistance while aiding persons less likely to be living in substandard dwellings and more likely to be able to finance their own home repairs. If homeowners as well as renters were made eligible for vouchers, the Congress might therefore wish to limit the proportion of available assistance going to owner-occupants. The Congress might also want to require that homeowners repay some or all of their subsidies out of any capital gains they realize when they sell their homes.[3]

Rationing Aid. Whatever eligibility limits were established for a voucher program, localities would almost certainly still have to ration aid, because it is unlikely that all income-eligible households could be served immediately within present budget constraints. Such rationing already occurs under present housing assistance programs, guided in part by federal regulations. Under a voucher program, the Congress might wish to establish preferences or set-asides for certain classes of households to direct local agencies in selecting recipients. Agencies could be required, for example, to grant preference to households displaced from their present homes, to families with especially heavy housing-cost burdens, or to persons living in deficient housing. Applying either of the latter two criteria carries some risk of penalizing frugal households and those that value physically adequate housing sufficiently to seek it out without aid. Another alternative would be to target voucher assistance on households

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2. (Continued)
renters but a larger share of those homeowners who did enroll eventually qualified for aid. Homeowners who repaired their units in order to qualify for assistance spent slightly less on average than did the owners and occupants of rental units. On the other hand, voucher payments appear to induce a significant amount of voluntary improvements to owner-occupied dwellings--a result not observed among rental units. See U.S. Department of Housing and Urban Development, Experimental Housing Allowance Program: Conclusions, The 1980 Report (February 1980); and John E. Mulford and others, Housing Consumption in a Housing Allowance Program (The Rand Corporation, forthcoming).

3. Such recapture provisions already apply under the Section 235 homeownership assistance program and the FmHA Section 502 homeownership loan program.

with persistently low incomes--households who are especially likely to be living in physically deficient units as a matter of necessity.[4]

Rent Limitations

A second voucher issue concerns whether to establish maximum allowable rent levels or to permit households access to the entire housing market.

Prohibiting assistance recipients from renting units costing more than specified maximums--as is now done in the Section 8 existing-housing program--would limit households' out-of-pocket housing costs but would also restrict their housing choices and would confine the additional housing demand generated to a narrower band of the market. That, in turn, could result in larger rent increases for recipients while increasing inflationary pressures on nonparticipants renting units in the same market segment. By contrast, limiting the size of the subsidy while allowing recipients to rent any physically adequate unit regardless of cost would broaden beneficiaries' housing choices and would dissipate demand, thereby reducing inflationary pressures.

Experience in the housing allowance experiments and in the Section 8 existing-housing program provides information concerning the apparent effects of allowing voucher recipients unrestricted choice among physically adequate housing units. Under the uncapped housing allowance program, recipients chose units with rents that distributed themselves fairly widely around the payment standards, with large numbers of households selecting lower-cost units and many other households choosing units renting for more than the benchmark amounts. By contrast, under the Section 8 existing-housing program--where the Fair Market Rents act as both subsidy caps and rent maximums--the great majority of all households choose units renting for within a few dollars per month of the maximums. Initial rent increases upon entering the programs also differed appreciably. Tenants joining the uncapped housing allowance program while remaining in physically standard units

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4. For an analysis of the implications of targeting aid in this manner, see Sandra Newman and others, Poverty, Housing Deprivation and Housing Assistance (The Urban Institute, January 1982).

experienced rent increases averaging less than 2 percent, compared to 6 to 26 percent average rent increases experienced by comparable Section 8 existing-housing recipients.[5] Some observers suggest that the Section 8 rent ceiling may even act as a floor, signaling landlords as to what rent levels both tenants and administering agencies will accept and encouraging property owners to raise rents to those levels. Indeed, in a 1976 survey, a substantial number of Section 8 landlords reported that they raised their rents specifically to meet the Fair Market Rent amounts.[6]

The choice between a capped and an uncapped program also has implications for program costs. Under a capped program, such as Section 8 existing-housing, continuing pressures to raise the maximum allowable rents can be expected as the only means of expanding recipients' housing choices. Such increases, in turn, raise federal expenditures. Under an uncapped program, by contrast, the payment standards could be increased more slowly as a means of controlling program costs without automatically making large portions of local housing markets inaccessible to voucher recipients. If the subsidy caps were set too low, however, the size of the subsidy itself could begin to seriously limit participants' housing choices.

Nature of the Payment

Another design issue is whether payments should be made directly to assisted households or--in the case of renters--to their landlords. Making cash payments directly to assisted households presupposes that they can be relied upon to meet their obligations as tenants and that the federal government need not--or should not--intervene in the relationship between a tenant and a landlord. Conversely, making the payments to the property owners implies greater distrust of households and a more interventionist role for government.

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5. C. Peter Rydell and others, Price Increases Caused by Housing Assistance Programs (The Rand Corporation, October 1980).

6. U.S. Department of Housing and Urban Development, Lower Income Housing Assistance Program (Section 8): Nationwide Evaluation of the Existing Housing Program (November 1978), p. 64.

Findings from the Experimental Housing Allowance Program, where payments were made directly to households, do not indicate that direct-payment recipients fail in large numbers to meet their obligations as tenants. On the other hand, there is some evidence that the poorest households in tight markets can benefit from assistance in arranging for needed repairs or in locating suitable housing elsewhere.[7] Thus, if aid is provided directly to tenants, administering agencies might still be encouraged to provide supportive services for households seeking either to relocate or to arrange for repairs to their present units.

Budget Treatment

A final set of voucher issues concerns how to fund such a program. Specific questions include how long the assistance commitments should run and what funds should be used to finance them.

Duration of Commitments. Housing vouchers could be financed through much shorter subsidy contracts than govern current housing assistance programs because there would be no need to assure property owners long-term rental income streams in order to induce them to undertake costly construction or rehabilitation. Although promises of aid for only one year might be insufficient to cause households to relocate or to press their landlords to correct housing deficiencies, three- to five-year commitments would probably provide enough time for those households who chose to do so to adjust their housing consumption.[8] Assistance commitments

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7. Findings from the housing allowance experiments show that in four areas with 4 to 6 percent vacancy rates in low-income rental submarkets, black-headed households seeking to qualify for payments in their pre-enrollment dwellings and both black- and white-headed households planning to move were substantially more likely to qualify eventually for payments when the local administering agencies provided high levels of supportive services. W.L. Hamilton and others, Administrative Procedures in a Housing Allowance Program: The Administrative Agency Experiment (Abt Associates, Inc., March 28, 1977), pp. 13-15.

8. One study of mobility among the poor found that, depending on the region of the country in which they lived, between 62 percent and 81 percent of all low-income renters moved in the (Continued)

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that ran for shorter terms than the present 15- to 40-year subsidy contracts would reduce initial funding requirements, because less spending authority would have to be set aside to cover eventual subsidy costs. Shorter commitments would also increase the government's control over near-term outlays, because a greater number of assistance agreements would come up for renewal--and, thus, be subject to cancellation--each year.

Source of Funds. A housing voucher program could be financed through new appropriations or through the transfer of funds already appropriated to support new-construction subsidy commitments. If the latter approach was adopted, funds appropriated but not yet committed to other programs could be shifted to vouchers. Taken one step further, already-executed new construction commitments could be cancelled--by mutual agreement between project owners and the government--and unspent funds could be reobligated for vouchers.[9]

Because vouchers would be much less costly than current new construction programs, shifting funds from the latter to the former would mean that more households could be assisted at no net additional federal expense, that overall federal spending could be reduced, or both. If all of the 1982 new-construction/substantial rehabilitation funds were reprogrammed for vouchers with five-year assistance terms, approximately 90,000 more households could be aided in that year at about the same annual expense and at a potential reduction of $8 billion in long-term federal obligations. If already executed new-construction subsidy agreements were also cancelled and the funds shifted to vouchers, still more households could be aided at no increase in near-term outlays. However, because any such shift would reduce the average duration

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8. (Continued)
five-year period from 1968 to 1973. Experience in two of the largest EHAP cities indicates that between 37 percent and 59 percent of all renters receiving assistance moved within two years of joining the program. HUD, Experimental Housing Allowance Program: Conclusions, The 1980 Report, pp. 33-34.

9. Under such an agreement, project owners might be allowed to retain the benefits of any secondary financing subsidies associated with their projects. Section 8 households living in the buildings at the time of the cancellation could be guaranteed assistance for the duration of their tenancies and could be provided with vouchers after they moved out.

of outstanding subsidy commitments, reprogramming funds in this manner would also make it easier for the government eventually to withdraw aid from current recipients.

BLOCK GRANT ISSUES AND OPTIONS

Issues likely to arise in designing a housing block grant--either as the sole federal housing asssistance device or in conjunction with other new programs--include:

- How recipient governments should be permitted to use funds;
- What jurisdictions should receive aid;
- What factors should be considered in allocating funds among jurisdictions; and
- How the program should be financed.

How these issues are resolved would likely depend in large part on whether block grants were expected to provide all housing aid or were intended to supplement a federally administered voucher program and, perhaps, a separate production subsidy.

Use of Funds

Whether and how to restrict the use of block grant funds presents a basic policy dilemma. On the one hand, largely unrestricted aid would provide less assurance that federal policy objectives would be achieved. On the other hand, limiting the use of funds would undermine local discretion--one of the principal benefits claimed for block grants. If the Congress chose, it could limit the use of block grant funds according to the incomes of the households aided, the types of dwelling units to which funds could be applied, or the linkage of block grant funds to other housing assistance programs.

Household Income Restrictions. Block grants in areas other than housing often require that funds principaliy or exclusively benefit some class of persons or households, frequently defined by their income. The use of housing block grants could be similarly restricted by requiring that all aid benefit families with incomes no greater than some specified percentage of the area median. If

block grants were adopted as a substitute for all federally administered housing assistance, then it might be necessary to restrict aid to households with incomes no greater than 50 percent of the area median in order to avoid appreciably redirecting assistance to better-off persons. If, on the other hand, block grants supplemented a lower-income voucher program, income-targeting might be of somewhat less concern.

Dwelling-Unit Restrictions. The use of block grant funds could also be restricted by the types of dwelling units involved. If block grants replaced all federally administered housing programs, the Congress might wish to require that a substantial portion of the block grant funds be used to aid renters, who are generally less well housed than homeowners. If, instead, block grants supplemented a federally administered voucher program, a larger share of the block grant assistance might be used to aid homeowners. In either case, the Congress might also choose to establish preferences or funding set-asides for locally designed efforts serving households with special housing needs, such as the elderly, handicapped persons, or large families.

Program-Linkage Restrictions. A final targeting consideration concerns whether to require that states and localities link the use of their block grant funds to any federally administered housing aid. If block grants supplemented a voucher program, for example, the Congress might want to consider requiring that states and localities use some share of their block grant funds to finance repairs to dwellings occupied by voucher recipients. Such a restriction would limit local discretion but would assure that the block grant funds benefited lower-income persons and would fill a potentially significant gap in that vouchers alone do not appear to induce the rehabilitation of seriously deficient dwellings.

Eligible Jurisdictions

A second general block grant issue concerns what jurisdictions should be eligible to receive funds. Housing block grant proposals typically call for large cities and urban counties to receive allocations directly. Funds for smaller cities and for nonurban areas could be allocated directly to those jurisdictions

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or could be provided to states for subsequent distribution among the smaller units of government.[10]

As with other issues, the decision regarding what jurisdictions should be eligible to receive funds directly would likely depend on the eventual uses to which the block grants were expected to be put. If block grants were expected to subsidize the construction of new multifamily rental projects, some minimum size for direct-recipient jurisdictions might be necessary to assure that each area's allocation would be large enough to support a viable newly built housing project. Limited-use block grants emphasizing housing rehabilitation might, on the other hand, be allocated directly to appreciably smaller jurisdictions.

The Allocation of Funds

The factors used to allocate grants among participating jurisdictions might also depend on the expected use of funds. If block grants provided all lower-income housing assistance, the allocation formula might emphasize measures of housing need among low-income persons, such as the incidence of substandard housing, overcrowding, or excessive housing costs among the poor.[11] By contrast, a block grant that was less narrowly targeted on lower-income households might be distributed through a formula emphasizing the condition of the housing stock as a whole. In either case, the Congress might also wish to include factors measuring the capacity and willingness of local governments to finance aid on their own--granting larger allotments to jurisdictions with

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10. In 1981, the Congress amended the CDBG program to incorporate such a two-tiered allocation scheme, permitting state governments to distribute the small cities' grants within their boundaries.

11. Currently, HUD's rental assistance funds are allocated through a formula taking into account each jurisdiction's total population, low-income population, housing quality, overcrowding, and housing vacancy rate, as well as the number of rental households experiencing high housing-cost burdens, housing inadequacy, or overcrowding. For an analysis of the current allocation scheme, see John L. Goodman, Jr., Regional Housing Assistance Allocations and Regional Housing Needs (The Urban Institute, September 1979).

more limited revenue sources and to those that already tax themselves more heavily.[12]

Budget Treatment

A final block grant issue concerns how such a program might be funded. Here too, the choice may depend on the expected scope of the program.

A comprehensive block grant that was expected to fund long-term subsidy agreements for lower-income persons living in newly built housing would likely have to be funded through multiyear spending authority, as are present federally administered lower-income new construction programs. If such multiyear funding was provided, the Congress might choose to limit the rate at which the spending authority could be drawn upon, in order to control the pace of outlays. Even so, there would probably be a good deal of uncertainty regarding the timing of expenditures, particularly in the years immediately following implementation.

A limited-use block grant that was not expected to fund long-term assistance agreements could more easily be financed through annual appropriations, with no limitations on the rate of outlays. Expenditures under such a program would probably follow more closely upon federal obligations, making outlays both more predictable and more easily controllable than they would be under a less restricted block grant.

PRODUCTION SUBSIDY ISSUES AND OPTIONS

If the Congress replaces current lower-income housing assistance programs with either vouchers or block grants, it is also likely to consider separate proposals for subsidizing the production of rental housing projects that would be available primarily to better-off households as a less costly substitute for the abandoned lower-income construction aid. Issues likely to arise in designing a supplementary rental housing production subsidy include:

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12. Fiscal capacity measures are currently used to allocate funds under the General Revenue Sharing (GRS) and Medicaid programs. The GRS formula also employs a measure of fiscal effort.

- How to target aid;
- When to provide assistance;
- What subsidy device to employ;
- How large a subsidy to provide; and
- Whether the subsidy should be subject to recapture.

Targeting Assistance

A new rental housing production subsidy could be left unrestricted or could be targeted by tenant income, by the type of dwelling units involved, or by the location of the buildings. Unrestricted subsidies would minimize federal intervention in private market decisions but would probably more often help finance construction that would have occurred in any event.

Tenant Income Restrictions. Any new less costly rental housing production subsidy designed to supplement a low-income housing voucher program would necessarily serve primarily better-off persons than would benefit from the voucher aid. The Congress could, nonetheless, target the production subsidy somewhat by tenant income in either or both of two ways. First, assisted projects could be made available only to tenants with incomes below some threshold level set above the eligibility limit for the voucher program but low enough to exclude the highest-income persons who could readily afford unsubsidized rents. Alternatively, some share of the units in assisted projects could be set aside for low-income tenants, perhaps with some additional subsidy provided for those families.

Unrestricted aid would less directly target immediate program benefits but could free up other housing units in local markets, allowing a chain of households to improve their living conditions through a filtering process. By contrast, targeting assistance by income in either of the ways described above would assure that the units were immediately available to less-well-off persons but would probably increase program costs by requiring larger subsidies.

Dwelling-Unit Restrictions. New-construction subsidies could also be limited to structures serving persons with special housing needs. Some have argued, for example, that the aging of the

population in the years ahead will create a particular need for smaller, easy-access dwellings designed for the elderly. It is also often argued that if a greater number of readily affordable smaller rental units were available to older persons, more of them would move out of larger homes, making those dwellings available to larger households. Additional housing especially designed for the elderly could also provide settings for offering noninstitutional long-term care. Similar arguments have been made regarding the need for additional units suited to the special needs of the physically handicapped. Targeting aid in any such manner, however, presupposes that the government could correctly identify housing submarkets in which persistent imbalances between demand and supply are likely to occur.

Location Restrictions. A third means of targeting any new rental housing production subsidy would be to limit aid to only certain types of housing markets or to designated locations within markets. Options include limiting subsidies to markets with acute and persistent housing shortages; making aid available only to physically and economically distressed communities; and targeting assistance to pockets of distress within jurisdictions.[13] Any such restriction would, however, present potential problems in designating target areas. The difficulty would probably be especially great in identifying "tight" housing markets, for which data are scarce and definitions not readily agreed to. More experience exists in targeting assistance on distressed areas.

The Timing of Aid

A second production subsidy issue is whether to provide assistance each year as a matter of course or to limit aid to periods of slack construction activity. If the Congress viewed the production of rental housing to be insufficient even during periods of peak construction, then it might consider providing aid as a matter of course. If, instead, production was considered to

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13. Geographic restrictions currently apply in the Government National Mortgage Association (GNMA) "targeted tandem" mortgage assistance program, which subsidizes moderate-income rental projects located in areas qualifying for UDAG assistance. Under current law, rental projects located in distressed areas are also granted a slight preference in qualifying for tax-exempt mortgage bond financing.

be adequate during construction peaks, financing subsidies might be limited to slack periods. Experience under previous countercyclical housing assistance programs, however, suggests the difficulty of timing the stimulus to occur during the housing production trough rather than after the recovery has already begun. Appropriating funds in advance to be released automatically when certain conditions occur would be one way of addressing that problem, but such an approach would require that the Congress agree on what the trigger conditions should be.

Subsidy Devices

Rental housing production subsidies could be provided through any one, or some combination, of several different devices, most of which would involve reducing the effective interest rate on project mortgages. Specific options--summarized in Table 9--include: the purchase and resale of privately written reduced-interest mortgages; one-time mortgage assistance or capital grants; annual mortgage-interest-reduction payments; direct reduced-interest loans; and reduced-interest mortgages financed through tax-exempt bonds. Each of these approaches either is incorporated in some current housing program or has been proposed legislatively in recent years.

One option for subsidizing new rental housing would be to use the so-called "tandem" mortgage assistance device, through which the government contracts with private lenders to purchase specially written reduced-interest loans at face value and resells them as market-yield instruments, absorbing the price difference as a financing subsidy. Such a mechanism--already employed by the Government National Mortgage Association (GNMA) to provide financing subsidies for Section 8 projects and for moderate-income rental housing located in distressed areas--would offer developers known financing charges and would limit government involvement to a short period of time. Such a device would also be highly efficient, with nearly all of the federal expense passed along to the project owner as a subsidy. On the other hand, the cost of such aid to the government would be difficult to forecast because of uncertainty regarding what market interest rates might be when the loans are eventually resold. Such a program would involve substantial near-term outlays when the mortgages were purchased; partially offsetting receipts would occur when the loans were resold, with the timing of sales dependent on interest rate fluctuations.

TABLE 9. ALTERNATIVE RENTAL HOUSING FINANCE SUBSIDY DEVICES

Subsidy Device	Efficiency (Proportion of Federal Expenditure Benefiting Project Owner)	Certainty Regarding Size of Federal Expenditure	Timing of Expenditures	Duration of Federal Administrative Involvement
Tandem Mortgage Assistance	High	Uncertain	Large outlays when mortgages are purchased. Partially offsetting receipts when loans are resold; timing of sales uncertain.	Short-term
Mortgage-Assistance or Capital Grant	High	Certain	Full, net, constant-dollar value of subsidy expended when construction is complete.	Short-term
Annual Interest-Reduction Payments	High	Certain	Spread out over life of the loans.	Extended
Direct Loans	High	Certain[a]	Large outlays when loans are made. Offsetting receipts spread over life of the loans.	Extended
Tax-Exempt Financing	Low	Uncertain	Tax revenue losses spread over the life of the bonds.	Short-term

a. While the size of the interest subsidy under a direct loan would be known at the outset, there might be less certainty regarding the eventual total federal expenditure because of the risk borne in the case of defaults.

Providing financing assistance through outright grants to private mortgage lenders--allowing them to write loans at reduced interest rates while realizing market rates of return--would control government expenditures by shifting the risk regarding future interest rates from the government to potential developers. Rather than guaranteeing a fixed interest rate to the developer, a front-end mortgage grant would promise to reduce the rate by a fixed number of percentage points below whatever the prevailing market rate proves to be when the loan is written.[14] Such a mechanism would be as efficient as the tandem plan in terms of the share of the federal expenditure passed on to project owners and would entail an even shorter federal involvement. On the other hand, the absence of any guarantee regarding eventual financing charges might make developers less eager to participate. A different form of this option would be to provide capital grants directly to project developers, reducing the portion of total development costs that they would be required to finance.

A third financing subsidy option would be to provide annual interest-reduction payments to a mortgage lender on behalf of the borrower/developer. This mechanism--used under the now-inactive Section 236 rental assistance program--would provide an assured interest rate to the borrower as well as an assured cost to the government. Outlays under such a program would be spread over many years, substantially extending the period of federal involvement.[15] That, in turn, would likely raise federal administrative costs but could also enhance the government's ability to control rents in assisted projects.[16]

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14. In 1980 and again in 1981, the Carter Administration proposed that such a mechanism be used to provide financing subsidies for Section 8 new construction projects, but the proposals were not acted on by the Congress.

15. Proposals to provide rental housing financing subsidies through such a device were reported out of both the House and Senate Banking Committees in 1980. The House proposal passed that chamber but was dropped in conference with the Senate.

16. Total outlays, in nominal dollars, under an interest-reduction payments program would exceed expenditures under either a tandem assistance program or a mortgage grant. In constant-dollar terms, however, federal costs would be rougly equal.

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A fourth alternative would be to provide developers with direct loans at reduced interest rates, as is now done under FmHA's Section 515 rental housing loan program. Such an approach would offer an assured interest rate to the borrower and a known cost to the government.[17] On the other hand, direct loans would entail substantial early expenditures and an extended federal administrative involvement. Providing direct loans for this purpose would also increase total federal credit activity--a matter of growing concern--and would place the government in direct competition with private lenders. Such an approach could also involve substantial risks to the government in the case of default.

Finally, subsidies could be provided by allowing developers to finance projects with proceeds from state or local bonds on which the interest would be exempt from federal taxation. The cost to the government of such a subsidy would be in the form of forgone tax revenues rather than direct expenditures--a relatively inefficient subsidy device because a large share of the revenue loss would benefit the purchasers of the bonds rather than the project owners. The Mortgage Subsidy Bond Tax Act of 1980 permits such financing for rental housing projects in which 20 percent of the tenants (15 percent in targeted areas) have incomes below 80 percent of the area median.[18] Extending this authority to other types of rental housing would increase the total volume of tax-exempt bonds, thereby exerting upward pressure on all tax-exempt interest rates.

The Size of the Subsidy

Another important issue is how large a subsidy to provide--a choice that would affect project owners' debt-service expenses, the income group that could readily afford to rent the assisted

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17. Under a direct loan program, some of the subsidy is provided merely by passing along the benefits of the government's lower borrowing costs. Any interest rate reduction below the federal cost of funds would result in a net interest expense to the government.

18. For a description of experience to date under this act, see Congressional Budget Office, The Mortgage Subsidy Bond Tax Act of 1980: Experience Under The Permanent Rules (March 1982).

units, and the cost of the program to the government. The value of any subsidy, of whatever size, would be realized through some combination of (a) the construction of housing projects that would not otherwise have been profitable--and, therefore, would not otherwise have been built--and (b) reduced rents in projects that would have been built in any event. To the extent that subsidies merely increase the net return on investment for projects that would have been built in any event, with no associated reduction in tenant rents, the federal expenditure would result only in windfall gains to the property owners. The choice regarding the size of the subsidy thus involves a tradeoff between promoting additional construction and providing housing for less-well-off households, on the one hand, and controlling federal expenditures and avoiding windfall profits, on the other.

The larger the subsidy--whatever share was passed along to tenants--the greater would be the reduction in project owners' debt-service expenses and, therefore, the greater the potential production stimulus. Every one-percentage-point reduction in the effective interest rate on a level-payment 40-year mortgage from a prevailing market rate of, say, 15 percent, for example, would reduce debt-service costs by about $500 per year on a unit with a $50,000 mortgage. A three-percentage-point interest subsidy--to an effective rate of 12 percent--would reduce yearly expenses by about $1,500 per unit; a seven-percentage-point subsidy would lower debt-service costs by approximately $3,400 per unit (see Table 10).

To the extent that subsidies were passed along to tenants, larger subsidies would make aided projects more readily affordable for less-well-off tenants. Assuming annual operating expenses and utility costs of $2,500 per unit and a pre-tax return to project owners of 6 percent on their initial investments, a three-percentage-point interest subsidy--if fully passed along to the tenants--could reduce yearly gross rents from $10,400 to $8,900 per unit. At the lower rent, families with annual incomes up to $30,000 could afford the dwellings while paying no more than 30 percent of their incomes toward shelter. That income level would correspond to about 97 percent of the projected median family income in 1985--the year in which projects aided in 1983 would become occupied. A seven-percentage-point interest subsidy would enable a family with an income equal to 76 percent of median to afford the unit while paying 30 percent of its income for housing.

While larger subsidies might provide a greater construction stimulus and could benefit lower-income persons, they would also

TABLE 10. COSTS AND EFFECTS OF ALTERNATIVE RENTAL HOUSING MORTGAGE-INTEREST SUBSIDIES (In dollars)

	Project Financed With 15 Percent Interest Mortgage	Effective Interest Rates on Reduced-Interest Mortgages		
		12 Percent	10 Percent	8 Percent
Reduction in Annual Debt-Service Costs per Unit	---	1,470	2,420	3,350
Household Income Needed to Afford Unit at Gross Rent Equal to 30 Percent of Income	34,500	29,600	26,400	23,300
Household Income as Percent of Projected Median Family Income[a]	(113)	(97)	(86)	(76)
Average Federal Expenditure per Unit (in 1983 dollars)[b]	---	9,400	15,500	21,500

SOURCE: CBO estimates.

NOTE: All figures are for a housing unit with a 40-year $50,000 mortgage that is assumed to be prepaid in 20 years. Non-debt-service housing costs are assumed to average $2,500 annually per unit. The pre-tax return to the project owner on his initial investment is assumed to be 6 percent.

a. Household income expressed as a percent of the projected median family income for fiscal year 1985--the year in which projects assisted in 1983 are assumed to be occupied.

b. Figures represent total federal expenditures required through mortgage grants or tandem mortgage assistance to provide the financing subsidies shown. The constant-dollar costs of providing similar subsidies through other direct expenditure devices would be roughly equivalent.

require larger federal expenditures. The estimated cost in 1983 dollars of a subsidy sufficient to reduce the effective mortgage interest rate from 15 to 12 percent, for example, would be about $9,400 per unit, assuming an average mortgage of $50,000 and an average effective mortgage life of 20 years. A seven-percentage-point subsidy would cost $21,500 in 1983 dollars.[20]

Recapture Provisions

A final issue is whether or not to require project owners to repay any part of the subsidy out of capital gains realized upon the sale of their projects. Recapture requirements would reduce federal costs but could also make potential developers less willing to participate and less concerned about maintaining their properties.

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20. Although the constant-dollar value of the federal payments would be roughly the same under all direct-expenditure subsidy devices for the same sized interest-rate reduction, the size and timing of outlays would depend as well on the subsidy mechanism used. Under front-end subsidy devices--tandem mortgage assistance or a mortgage assistance grant--the full present-dollar value of the subsidy would appear as a net federal outlay shortly after the mortgage was written. If the subsidy was provided instead through annual interest-reduction payments, outlays would be spread out over the effective life of the mortgage. Under a direct loan program, a substantial initial disbursement would be followed by a long period of repayments; the eventual cost to the government would be equal to the difference between the interest collected on the loan and the government's borrowing costs.

    Under tax-exempt bonds, the size of the subsidy would depend on the spread between prevailing tax-exempt interest rates and private mortgage rates. The federal expenditure would occur as a stream of forgone tax revenues, with the size of the revenue loss dependent on the effective interest rates on competing taxable investments and on the marginal tax brackets of the bond buyers.

Any recapture provision would likely require that owners apply some share--say, 50 percent--of any capital gain to repaying the government, with the total repayment limited to the constant-dollar value of the subsidy. The amount of subsidy recaptured might also be made to vary with project characteristics--by, for example, imposing less stringent recapture provisions on projects serving less-well-off persons or those located in distressed areas.

APPENDIX. COMPARISON OF 1982 HOUSING AND COMMUNITY DEVELOPMENT ACTS REPORTED OUT OF SENATE AND HOUSE BANKING COMMITTEES

In May 1982, bills that would significantly amend current housing and community development programs were ordered reported out of the Committee on Banking, Housing, and Urban Affairs of the U.S. Senate and the Committee on Banking, Finance and Urban Affairs of the U.S. House of Representatives. Each of these bills--the Housing and Community Development Amendments of 1982 and the Housing and Urban-Rural Recovery Act of 1982 (H.R. 6296), respectively--would incorporate some of the policy options discussed in this paper. This appendix compares key provisions of the two bills, with respect to lower-income rental assistance, rural housing assistance, and supplementary rental housing construction and rehabilitation aid.

APPENDIX TABLE 1. SELECTED PROVISIONS OF 1982 HOUSING AND COMMUNITY DEVELOPMENT ACTS REPORTED OUT OF SENATE AND HOUSE BANKING COMMITTEES

Senate Bill	House Bill (H.R. 6296)
Lower-Income Housing Assistance	
Repeals most authorities for making additional Section 8 and public housing new construction/ substantial rehabilitation assistance commitments except in the case of certain projects set aside for elderly or handicapped persons.	Maintains present lower-income rental assistance authorities.
Authorizes new rental housing voucher program through modifications to Section 8 existing-housing program. o Subsidy equal to difference between payment standard and 30 percent of adjusted income for most households. Assisted households may choose any physically adequate unit regardless of rent charged. o Does not specify initial level of payment standard; provides for two adjustments in the value of the subsidy within a five-year period. o Subsidy to be paid to landlord on behalf of assisted household.	Amends eligibility and size of subsidy under present rental assistance programs. o Alters eligibility for Section 8 assistance to permit up to 70 percent of all households to have incomes greater than 50 percent of the area median. (Present law permits between 5 percent and 10 percent of all assisted tenants to have incomes greater than 50 percent of the area median.) o Lowers required tenant contribution for assisted housing from 30 percent of adjusted income permissible under current law to 25 percent of adjusted income. o Specifies that Section 8 existing-housing Fair Market Rents be set at levels equal to median rents of units occupied by recent movers. (Present law does not specify the level at which Fair Market Rents should be set.)

(Continued)

APPENDIX TABLE 1. (Continued)

Senate Bill	House Bill (H.R. 4206)
Authorizes $7.2 billion in additional assistance commitments or amendments to prior commitments; 1983 activity to be funded through the deobligation of outstanding commitments or, as needed, new appropriations. Expected to support: o 15,000 additional Section 8 new construction/substantial rehabilitation assistance commitments to be used in conjunction with reduced-interest Section 202 project loans to aid elderly and handicapped persons not previously assisted. o 60,400 vouchers to aid households not previously assisted. o 16,000 vouchers to aid households currently receiving more limited subsidies or whose present subsidies are expected to expire.. o 60,615 vouchers and 5,000 Section 8 existing-housing assistance commitments to aid households already assisted under other programs. If fully funded through the deobligation of outstanding assistance commitments, would involve the reprogramming of funds that could have aided 40,000 households.	Authorizes $16 billion for additional assistance commitments or amendments to prior commitments; 1983 activity to be funded through new appropriations. Expected to support: o 20,500 additional Section 8 new construction/substantial rehabilitation assistance commitments to aid households not previously assisted--16,000 to be used in conjunction with reduced-interest Section 202 project loans to aid elderly and handicapped persons; 4,500 to be used for rehabilitation in targeted neighborhoods. o 19,000 additional public housing assistance commitments (including 4,000 for Indian housing) to aid households not previously assisted. o 25,000 Section 8 existing-housing/moderate rehabilitation assistance commitments to aid households not previously assisted. o 1,000 Section 8 existing-housing assistance commitments and 10,000 moderate rehabilitation assistance commitments to aid households currently receiving more limited subsidies or whose present subsidies are expected to expire. o 65,000 Section 8 existing-housing assistance commitments for households already assisted under other programs. Does not assume any net deobligation of outstanding assistance commitments.

(Continued)

APPENDIX TABLE 1. (Continued)

Senate Bill	House Bill (H.R. 6296)
Rural Housing Programs	
Eliminates interest subsidies for future FmHA rural housing loans. Permits FmHA to make $666 million in direct rural housing loans at market interest rates and to guarantee $229 million in privately written loans. Authorizes $850 million annually in fiscal years 1983-1985 to fund new rural housing block grant. o To be distributed on the basis of each state's rural population, rural population in poverty, and rural population living in substandard housing. o To be used to benefit families with incomes below 50 percent of the area median. Authorizes $37 million for several smaller rural housing grants and subsidized loans. Provides setaside of 10,000 vouchers for use in areas served by the FmHA (included in total number of vouchers shown above.)	Authorizes $3.7 billion in new reduced-interest homeownership and rental housing loans; $130 million in other loans and grants; $398 for new or extended rental assistance commitments; and $500 million in loan guarantees. Direct homeownership and rental housing loans and rental assistance funds expected to support: o Reduced-interest mortgages for 61,000 low- and moderate-income homebuyers.[a] o One-percent-interest rental housing loans covering 28,000 dwellings.[a] o New or extended rental assistance commitments for 42,000 households.[a]

a. Estimates provided by Committee staff.

APPENDIX TABLE 1. (Continued)

Senate Bill	House Bill (H.R. 629[illegible])
Supplementary Rental Housing Construction/Rehabilitation Subsidies	
Authorizes new rental housing construction and rehabilitation grants to large cities and urban counties and to states on behalf of smaller jurisdictions. o Funded through $300 million set-aside of funds authorized for the CDBG and UDAG programs. o Distributed through formula taking into account such factors as each jurisdiction's low-income renter population, rental housing market conditions, and the condition and use of the rental housing stock. o At least 25 percent of the units in newly built projects must be available to lower-income households for at least 10 years.	Authorizes new rental housing construction and rehabilitation grants for states and localities. o Funded through authorization of $1.3 billion in new funds. o Awarded on a competitive basis for proposals submitted by jurisdictions that qualify as experiencing a severe shortage of decent, affordable rental housing on the basis of such factors as: the extent and change in the level of poverty; rental housing substandardness, overcrowding and vacancies; and rental housing production lags. o At least 20 percent of the units in assisted projects must be avaiable to lower-income households for at least 20 years.

NOTE: This table describes the Housing and Community Development Amendments of 1982 as ordered reported out of the Senate Banking, Housing, and Urban Affairs Committee on May 6, 1982, and the Housing and Urban-Rural Recovery Act of 1982 as ordered reported out of the House Banking, Finance and Urban Affairs Committee on May 11, 1982. In several instances, descriptions are based on interpretations provided by Committee staffs.